Dato' Anuar Md. Nor

Securing Private Equity in Malaysia

Capital for your firm without going to your bank managers

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DEDICATION

I like to dedicate this book to my wife, Datin Azimah Rashid, who constantly reminded me to finish it. This book has taken a long time to complete and I could not account the number of hot tea cups she made during the process.

I would also like to dedicate it to my children, Mohd Harfiq, Mohd Haffendi, Noor Ira Nadiha and Hakel Yusuf who also pushed me hard to complete this book. They were my motivation and my toughest commentators.

Finally, I would like to dedicate this book to my MBA students at International Business School (IBS), Universiti Teknologi Malaysia. Their case studies on the private equity industry have been the main foundation of this book.

PREFACE

The brainchild of this book was inspired by my MBA students at the International Business School (IBS), Universiti Teknologi Malaysia (UTM), who had attended my class, "Venture Capital Management".

Venture capital or private equity has been the main source of capital that had contributed to the growth of famous high technology companies such as Intel, Apple Computer, E-Bay, Google and others. The list is long. Every year private equity managers in the United States of America (USA), Europe, India, China, Australia and Malaysia provide capital to growth firms with the expectation that they will reap huge capital gain when they sell these companies later.

I was fortunate enough to be involved in the private equity industry since the 1990s, when the private equity or venture capital industry was just developing in Malaysia. My first firm, PNB Equity Resources Sdn. Bhd, provided private equity to many promising Malaysian firms. Many of them became successful companies. These companies were able to source private equity and avoided the need for more expensive bank loans which usually required both collaterals and personal guarantees.

Many Malaysian entrepreneurs have the perception that private equity is not accessible to them, except those with corporate and political connections. This is far from the truth.

Private equity firms invest in private and family-owned companies. This investment approach involves considerable risk as it does not require collaterals or personal guarantee. Private equity firms do not recover their capital if their investments in private firms turn sour or bad. They will lose the capital and their share of profits from capital gain if realized in the future. They will also lose the confidence of investors who provide the private equity capital in the first place.

This book attempts to demystify the negative perception of private equity. I hope by reading this book, entrepreneurs will understand the decision-making process of private equity managers. Studies undertaken by my MBA students showed that private equity managers follow a systematic investment decision process.

Finally, I hope, after reading this book, entrepreneurs can increase their chance of securing capital without going to your bank managers. In addition, this book will also cover other sources of capital such as government grants and institutional investors. In conclusion, there are more private equity companies seeking attractive entrepreneurial opportunities than ever before. Thus, this is the right time for entrepreneurs to secure private equity capital.

Dato' Anuar Md. Nor,
Ampang, Selangor,
January, 2010.

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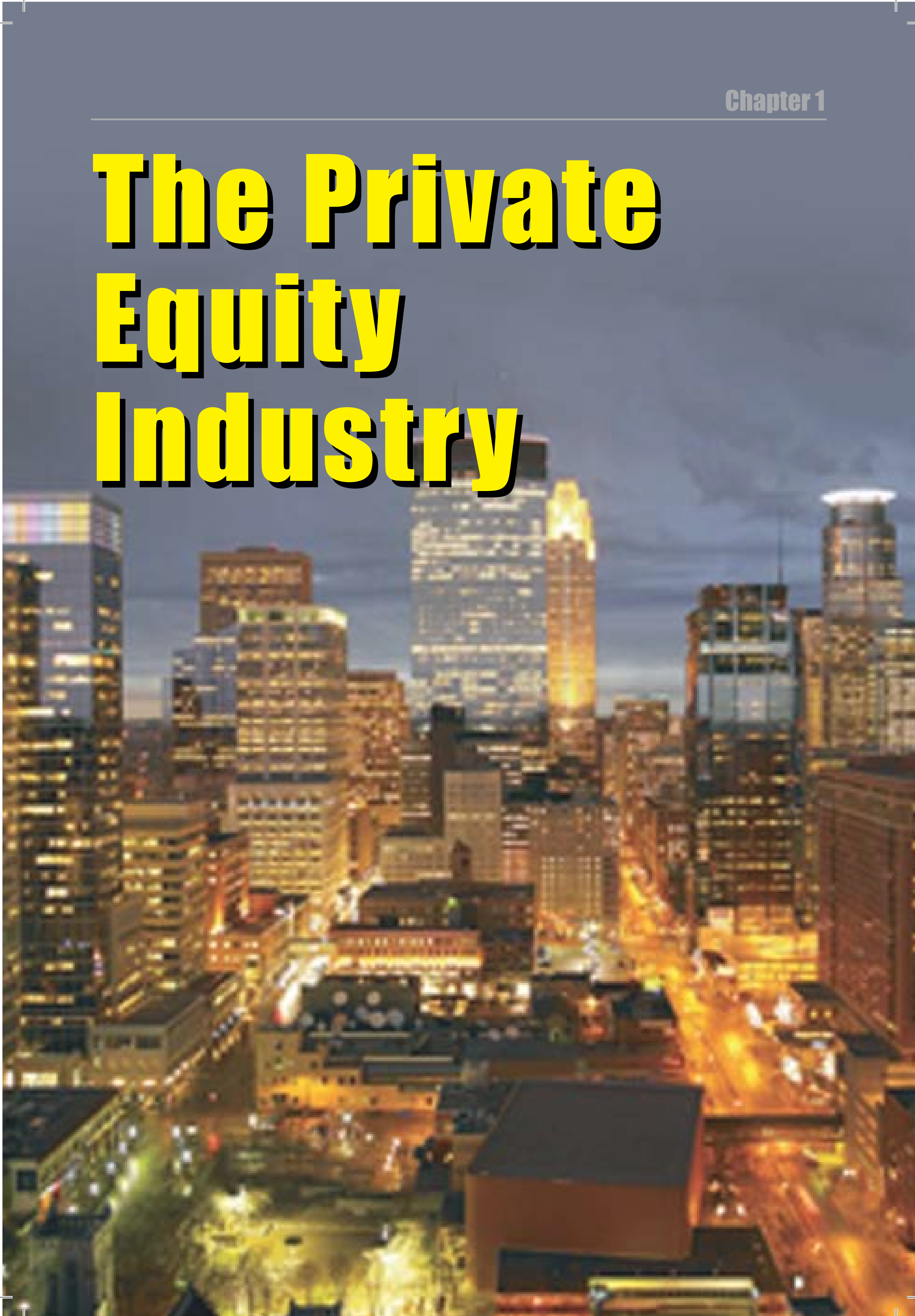

CHAPTER 1

The Private Equity Industry

My involvement in private equity started in 1983 when I joined Permodalan Nasional Bhd (PNB) as a Research Analyst after my MBA at the Bradford Management Centre, England. As a Research Analyst, I conducted detailed analysis of companies in which PNB would consider investing. Later, I was involved in private equity investment when PNB established its private equity arm, PNB Equity Resources Sdn Bhd.

The most interesting aspect of the private equity investment process was the lengthy negotiations that took place between us and the owners of the private firms. The main point of negotiation was to establish the value of the private firm which was acceptable to us and the entrepreneurs/shareholders. The negotiation could last as short as six months or as long as three years.

In 1990, PNB Equity Resources Sdn Bhd formed a private equity company with Nomura Jafco of Japan. The capital of the private equity company was RM50.0 million. Nomura Jafco was the largest private equity firm in Japan. The private equity firm would invest in subsidiary companies of Japanese firms in Malaysia. The main holding companies of these subsidiary companies in Japan were generally medium-sized companies

which had limited capital. Negotiation process with the Japanese firms was rather interesting and challenging. A typical negotiation normally took more than one year but in many cases the negotiation process could drag to more than three years when an investment agreement could be signed.

The negotiation process took that long because the Japanese owners had to be really “comfortable” with us before accepting our private equity fund. The Japanese owners generally were committed to list the companies on the stock market as part of the agreement to accept our private equity. In one investment, the Japanese owner and director of the company committed suicide in a rubber estate behind his factory because his company failed to list on the stock market. He left a suicide note saying that he betrayed the trust of his shareholders including us. This was probably too extreme!

In the last twenty years, I have had my full share of successful investments as well as several dismal investments. What is a good investment candidate and what is not? Most importantly, what are the types of companies that private equity managers will invest in and which ones do they generally avoid?

What Entrepreneurs Should Know

An obvious question for an entrepreneur is, “What exactly is private equity and how can I benefit from it?”.

A new or a growing firm requires a lot of capital. An entrepreneur may not have the capital to finance the company alone and therefore must seek outside capital. The traditional source of capital for entrepreneurs is bank borrowing, but the conditions attached to the bank borrowings may make his financial position very risky indeed. Usually, bank borrowings require the entrepreneur to provide physical securities such as land or properties. In addition, the entrepreneur also has to provide personal guarantee.

Many companies seek private equity because they have exhausted their own financial resources. They have to seek the extra capital without

the burden of an additional personal guarantee or collateral. Smart entrepreneurs use private equity to replace bank borrowings. Private equity firms finance growing companies by participating in the equity of private firms. They thus share the risk and reward with the entrepreneurs. In return for the capital, the firm will issue shares representing the capital injected by the private equity managers into the company.

Thus, the basic concept of private equity investment is to invest in growing companies with the expectation that the investment can be sold in the future with substantial capital gains. The capital used by the private equity managers are mainly provided by institutional investors or governments who believe private equity investments will generate higher return on the capital.

The Private Equity Investment Process

The private equity industry is in the business of promoting growth and managing risk. In this regard, a private equity firm serves as an intermediary between investors looking for high return and entrepreneurs in need of capital.

A number of features of private equity financing distinguish it from other types of capital investment. These features are:

- The provision of long-term finance (two to five years) for entrepreneurs.
- The provision of management and technical assistance (value-added services).
- An equity investment that generates long-term capital gain.
- Important investment evaluation criteria are the management team and market potential of a company rather than collaterals.
- High perceived risk to generate the expected return.

Private companies usually seek private equity because they are still too small or young to seek and qualify a stock listing. They welcome private equity investors as a preparation for seeking a stock exchange

listing because their private equity managers can help them through the complex procedures and regulation involved.

Private equity can provide the money needed to expand a company-money not readily available from other sources. Since private equity managers usually have had experience with other companies facing similar situations, they can add value by helping a company's plan for growth. This help is known as "value-added".

*Source: The 2000 Guide to Venture Capital in Asia

Private equity is an alternative to debt financing. Many companies which I invested welcome our private equity because their entrepreneurs could not afford to provide additional collaterals to secure bank loans. They also like to reduce the level of personal guarantee which was required as part of the debt financing.

Private Equity versus Debt Financing

Features	**Private Equity**	**Debt Financing**
Objective	Maximize return on capital	Ensure interest and principal payment
Holding period	2-6 years	Short and long term depending on types of debts
Instruments used	Common shares, preferred shares, convertible bonds	Loan, factoring, leasing
Pricing	Business valuation	Interest rate
Collateral required	None	Yes and personal guarantee
Equity ownership	Yes	No
Corporate control	Directorship, shareholders' protection, investment committee	Terms of loan agreement
Exit mechanism	Sales to a third party, public listing, merger and acquisition	Loan repayment

Activities of Private Equity Managers: The Investment Process

The investment process of private equity managers is divided into various stages. The main document used by the private equity managers in the investment process is the "Business Plan". Once a "Business Plan" is received by the private equity managers, the following stages are usually undertaken.

Stage 1: Initial evaluation and negotiation

Following the submission of the "Business Plan", private equity managers will use many of the following criteria to evaluate the "Business Plan". They include:

- The unique aspects of the products and services of the company.
- Outlook for the target market.
- The strengths of the management team.
- Potential return to the private equity capital managers.
- The commitment required from the private equity capital managers.

Stage 2: Due diligence

This is a process of investigating the business of the company to assess its potential for high investment return. Different private equity managers will adopt different approaches to undertake the due diligence process. Their approaches would have been developed based on their past experiences. They would contact and interview many parties such as suppliers, customers, bankers and even competitors. The private equity managers will review in detail the financial statements of the company.

Stage 3: Final negotiation and completion

The private equity manager will undertake the "valuation" of the company based on inputs and data gathered in Stage 2. Private equity managers will use different "valuation" techniques to arrive at a "value" of the company.

The private equity manager will also negotiate the financial structure of the investment, whether in the form of equity, debt or some combination. The specifics of the financial instruments involved will need to be agreed upon. In some cases, if the investment amount is substantial, the private equity managers may consider bringing other investors into the investment pool. This is called "syndication".

Stage 4: Monitoring

The private equity manager will have to monitor the company once an investment has been completed. The style of monitoring will also vary from one private equity manager to another. As a rule, involvement in the day-to-day aspects of a business will be greater during the earlier stage of the investment. Most often, the private equity firm will be granted a seat on the company's Board of Directors. It will monitor the major events of the company's business through the Board of Directors. Depending on the investment involved, the private equity managers will also be involved in the company through representation in various committees.

Stage 5: Exit

This is the last stage of a private equity manager's involvement in a company. This stage is often only realized after a certain period of time. Private equity managers exit from their investments by selling the shares back to the original owners, selling the shares to a third party or selling the shares through a public offering of the shares on a stock exchange.

The private equity industry has become an important source of capital

for entrepreneurs. At the same time, it is a conduit for investors and high net worth individuals to invest and realize a high investment return.

The private equity industry first started in Malaysia in the early 1980's and has grown in size driven by Malaysian government-backed private equity companies.

Many companies have benefited from capital provided by the private equity industry. Private equity has many advantages over the conventional bank loans. The book is written with the objective of guiding entrepreneurs to successfully secure capital from the private equity industry. It is hoped that the entrepreneurs are prepared before approaching a private equity manager for funding.

Private Equity Firm: An American Invention

The first private equity firm was American Research Development (ARD. It was formed in 1946 by Massachusetts Institute of Technology (MIT) president, Karl Compton, Harvard Business School professor, Georges F. Doriot and business leaders in Boston, USA. The ARD's famous investment was Digital Equipment Company. The ARD's investment in the company of US$70,000 became US$355 million within a few years. ARD was structured as a publicly traded closed-end fund and marketed mostly to individuals.

A new organization structure for private equity funds emerged later, and it was in the form of limited partnerships. Private equity partnership is now the most common structure of private equity funds.

The private equity industry grew significantly in the late 1970's and early 1980's. The most interesting time for private equity industry was the late 1990's and this coincided with the Internet boom. I remembered during this period, everyone I knew in Silicon Valley, a high technology center near San Francisco, USA, was a private equity investor. They were investors in many Internet companies which failed later during the Dot Com bust. I attended several breakfast presentations where would-

be Internet entrepreneurs made a 5-minute pitch to eager private equity managers and individual investors. These individual investors were called “angel investors”.

The growth of the private equity industry can be seen from the size of private equity funds managed by private equity managers. Currently, large private equity managers have billions of Ringgit of private equity funds to invest. Whilst the bigger private equity managers focus their investments in large companies, there are a large number of private equity firms that invest in smaller firms and start-ups. Thus, entrepreneurs with good business plans or growing businesses can find private equity firms that might listen to their growth stories and invest in their firms.

Where to Find Private Equity in Malaysia

The private equity industry began in Malaysia with the establishment of Malaysian Venture Bhd in 1984. I entered the private equity industry in 1988. Since then, the private equity industry has grown in size. The bulk of the private equity is managed by government-owned private equity companies.

The Malaysian private equity industry has formed an association called the Malaysian Venture Capital and Private Equity Association (MVCA). To-date, the MVCA has 53 members which, as a group, manages a total of RM4.57 billion of private equity funds as of December 31st, 2008. Please visit the website of the MVCA at www.mvca.com.my. I was the founding president of the MVCA. The directory of the members MVCA is provided in Appendix Section.

Who Have Benefited from the Private Equity Industry?

The private equity industry is regulated by the Securities Commission (SC). Under the regulation of the SC, the private equity industry has developed significantly in Malaysia. This has enabled the Malaysian Government to monitor the development of the industry.

In the earlier years, the private equity firms were mainly established by private investors. These private equity firms were more focused on investments in the expansion and Pre-IPO stage and they were not interested in investing in start-ups.

The gap of funding for start-ups was recognized by many parties. They lobbied to the Malaysian Government that government-backed private equity funds should be established to address this funding gap. Over the last few years, several government-backed private equity funds had been established to support the capital requirements of new start-ups, especially in specific technology sectors such as multimedia, communications, software, biotechnology and advanced materials.

The main government-backed private equity companies are Malaysian Technology Development Corporation (MTDC) and Malaysia Venture Capital Management Bhd (MAVCAP).

According to the SC, the status of the private equity industry can be gleaned from Table 1-1 below.

Table 1-1: The Malaysian Private Equity Industry

As of December 31st.	**2008**	**2009**
Number of funds/firms	56	52
Number of investee companies	450	433
Number of industry professionals	248	132

The number of private equity firms has increased significantly over the last few years, thanks to the effort of the government-backed private equity companies outsourcing their private equity management to other companies. The private equity companies are basically owned by Malaysians. The Malaysian private equity industry does not have a large presence of foreign private equity managers due to the modest size of investment opportunities available. Their investment focus has always been towards China and India.

Table 1-2 shows the size of the private equity according to fund managed.

Table 1-2: The Private Equity Fund Size

As of December 31st. {in RM Million}	2008	2009
Total committed funds under management	4570	3308
Total investment as end of period	1929	1784

The size of private equity capital has also expanded significantly with the increased number of private equity firms. The major portion of the private equity capital is managed by government-backed private equity firms.

Table 1-3 shows the financing stage of the investee companies of the private equity firms in Year 2008.

Table 1-3: Financing Stage of the Investee Companies

Business Stage	Total Investment in RM Million	% of Total Investment	Number of Investee Companies
Seed	12.757	3	31
Start-up	3.000	1	3
Early stage	82.785	17	21
Expansion/growth	298.632	62	65
Mezzanine/Pre-IPO	60.366	13	11
Management buy-in	11.500	2	2
Others	7.571	2	1
Total	476.611	100	134

The main stage of private equity investment is at the expansion and growth phase of companies. Companies in the early stages had also received a substantial amount of capital from government-backed private equity firms.

According to SC, of the total private equity of RM4.57 billion as of December 31st, 2008, about 48 percent was contributed by the Government of Malaysia while another 27 percent was contributed by commercial banks.

The Personalities of the Malaysian Private Equity Industry

Like any industry, the private equity industry has also its group of pioneers and leading personalities. On the global scale, leading private equity managers are well known in the financial world due to the enormous financial power they wield when come to making business acquisition deals.

Locally, several individuals are considered as leading private equity managers, and they have under management a substantial amount of funds. Among these individuals are En. Jasmani Abbas of Pembangunan Ekuiti Sdn. Bhd, En. Husni Salleh of Malaysia Venture Capital Management Bhd, En. Dali Sardar of DTA Growth Capital Sdn. Bhd, En. Mohd Daniel of Expedient Equity Ventures Sdn Bhd, Jerry Chin of MAVCAP Photonics Sdn Bhd, En. Zaini Deni of Mayban Venture Capital Company Sdn Bhd, En. Nor Idzam Ya'akub of Musharaka Tech Venture Sdn Bhd, En. David Fong of Spring Venture Management Sdn Bhd and En. Shahril Anwar of Kumpulan Modal Perdana Sdn Bhd.

The private equity industry requires individuals who have significant experiences in various disciplines such as corporate finance, corporate management, product marketing and corporate laws. In the U.S, leading private equity managers work together with their teams over many years to develop expertise of specific industries and technologies.

In Malaysia, several of the private equity firms specialize in a particular industry such as biotechnology or information communication technology. By specializing in a particular industry, the private equity managers will understand better the dynamic of the industry.

From the data gathered by SC, more than 500 companies in Malaysia has benefited from private equity during the various stages of their growth. How did these companies manage to secure private equity? This is the topic of Chapter 2.

How Malaysian Private Equity Managers Make Investment Decision

CHAPTER 2

How Malaysian Private Equity Managers Make Investment Decision

How Private Equity Managers Work

Understanding the investment style of private equity managers will increase the chance that a firm will be able to secure private equity. The style of private equity managers can be distinguished by the stage of investment that a particular private equity manager is willing to take.

Typically, a private equity manager divides firms into several stages of growth, and they are categorized as follows:

- The seed or start-up financing stage which deals with funding an idea or concept that needs financing to develop a product or service.
- The growth financing stage which deals with funding a company at the growth phase.
- Bridge or mezzanine financing stage which deals with funding firms at its final growth before going public.

Another activity of private equity firms is to buy struggling firms from

large industrial corporations. They acquire these struggling firms or divisions with the objective of making them more efficient and profitable. They will sell these companies later to other industrial buyers or list them of the stock market and realize huge profits. These private equity funds are generally called buy-out firms.

Specialization versus Generalization

Private equity managers can be categorized as generalist or specialist investors. As a generalist investor, the private equity manager invests in several industrial sectors. On the other hand, a specialist private equity manager invests only in specific sectors such as biotechnology or internet firms.

In Malaysia the private equity firms are mainly generalist investors while government-backed private equity firms are generally specialists as they are only allowed to invest in specific sectors.

How Malaysian Private Equity Managers Make Their Investment Decisions

A typical Malaysian private equity firm does not have a large staff number. The private equity company is normally inundated with applications from private firms for funding. Among these many applications, the private equity manager will select a small number of investments that meet their investment criteria. My own rule of thumb is that I will only invest in three to five good firms out of 100 applications.

The investment decision process of private equity firms in Malaysia follows a systematic process as indicated by a research undertaken by my MBA student, En. Sharbani Harun.

One of the main findings of the research is that there is a tendency of the Malaysian private equity managers to invest in companies which they are familiar with. He also identified that Malaysian private equity firms used six investment criteria and they are as follows:

- Management team of the firm.
- Target market of the firm.
- Products and services of the firm.
- Competitive positioning of the firm.
- Capital payback projection.
- Business plan of the firm.

Let me elaborate these six criteria.

Management Team

The Malaysian private equity firms considered that the management team is the most important aspect of a private company. They assess the team members based on skills, background and experience.

They also prefer that the management team has the ability to focus on customers' needs. The management team is able to create superior products or services, position the firm as a market leader, build core competences, manage changes in strategies and accept a change in roles of the management as the firm grows.

The second crucial skill included strong communication skills and outstanding marketing and sales skills. Product development skills are also highly regarded by private equity managers.

Private equity managers clearly considered outstanding marketing skills were important to the success of investing in a private firm. The private equity managers also emphasized the importance of investing in experienced management team. They wanted the management team to have strong leadership, a fact that can be demonstrated in the resume of the management team.

Target Markets of the Firm

The management team must demonstrate a strategy for the firm to

create long-term relationship with customers. The management team must demonstrate that they have clear understanding of the firm's target markets and are knowledgeable about customer needs.

Products and Services of the Firm

It is important that the firm's products and services are driven by large market demand.

Competitive Positioning of the Firm

As required by the private equity managers, the management team of the firm must be able to recognize changes in the economic climate affecting the firm and understand the trends within the firm's industry. The firm was also needed to identify strategic partnership such as those with larger companies.

Capital Payback Projection

Private equity managers were concerned about the period taken for a new firm specifically to reach positive cash flows. Before achieving a positive flow, normally a new firm had to face a "burn-rate". The "burn-rate" is the amount of cash that a firm needs to pay out each month without having a good revenue stream. The management team must examine the risks and develop a contingency plan to address shortfalls in cash flows.

Business Plans of the Firm

The Business Plan should provide the information required by the private equity firm to make an investment decision. The Business Plan should also provide a realistic financial projection. The executive summary of the Business Plan was an important tool in getting the attention of the private equity managers.

In order to make a good impression, the following factors should be considered by the management team when constructing a Business Plan.

- The business opportunity was presented in a clear and exciting manner.
- Financial projection was prepared on realistic assumptions.
- Furnished as full disclosure as possible on the pitfalls of the firm as well as its strengths.
- Business Plan proofread and edited until it did not contain any errors in grammars and miscalculation.
- Business Plan showed why the firm and its products were different and significantly better than the competitors.
- The firm understood the competitors and it was able to address their strengths and possible weaknesses.
- Business Plan did not make any exaggerated claims about the firm's products and services.

Table 2-1 summarizes the salient investment criteria used by Malaysian private equity managers to evaluate investment proposals.

1) Management Team

	Level of Importance		
Ranking Criteria	**Abilities**	**Background**	**Skills**
1	Focus on customer needs	Vision and commitment	Communication skills
2	Create values for shareholders	Leadership experience	Product development skills
3	Create superior products	Technical excellence	Marketing skills
4	High team performance	Reputation in business circle	Technical skills
5	Position as market leader	Entrepreneurial experience	Sales skills
6	Result oriented	Experience in working together	Negotiation skills
7	Building core competences	Industry work experience	Project management skills
8	Effective change management	Compatibility with private equity managers	Financial skills

The Malaysian private equity managers expect the management team of the company to possess good communication skills and the ability to focus on customer needs. A management team with effective product development skills is also a key factor in the evaluation of the company by the private equity managers.

2) Business Plan

Level of Importance	
Ranking	Criteria
1	Clarity of Executive Summary
2	Realistic financial projection
3	Reasonable business model
4	Good market analysis
5	Customer need analysis
6	Competitive analysis
7	Product & Services Analysis
8	Clarity of message

The findings also indicated that the Business Plan of the company must be able to show clearly the potential of the business through a realistic financial projection. The business model of the company should also be explained in details.

3) Competitive Positioning

Level of Importance	
Ranking	Criteria
1	Recognize impact of changes
2	Strategic partnership with larger firms
3	Respond to possible assault by competitors
4	Macroeconomic factors
5	Challenges by competitors

The entrepreneur must be able to identify its competitors and also act in response to the competitive challenges. He or she is also required to develop strategic partnerships with larger firms in the market place.

4) Capital Payback

Level of Importance	
Ranking Criteria	
1	Time to reach positive cash flows
2	Agreement of an exit strategy with private equity firms
3	Sales value that is profitable
4	Contingency plan
5	Profit margin
6	Identification of risk

The private equity managers will likely determine the time required by the company to reach positive cash flows. This is to compute the amount of investment required for the company. An agreement of an exit strategy for the private equity firm will also be very important.

5) Target Market

Level of Importance	
Ranking Criteria	
1	Relationship with customers
2	Creation of market niches
3	Effective distribution channel
4	Identification of targeted customers
5	First to market
6	Market growth rate
7	Creation of brand recognition
8	Develop competitive pricing

A strong relationship with the customers is an important factor to be considered by the Malaysian private equity managers. The growth of the market served by the company is also an important criterion for investment evaluation.

6) Product and Services

Level of Importance	
Ranking	Criteria
1	Innovative
2	Well defined market niches
3	Competitive prices
4	Clear customer requirements
5	Driven by large market demands
6	Superior to competitors' products
7	Keep pace with the changes in market needs

An innovative product and services strategy is considered an important factor by the private equity manager. In addition, the markets served by the company should also be large.

My Students' Findings of Investment Decision Process of Malaysian Private Equity Managers

Deal Screening and Deal Valuation

The findings are rather interesting. What was the time taken by Malaysian private equity managers to conduct due diligence on a potential investment? Among the private equity managers surveyed, over 81%, reported that they took days to weeks to screen an investment, and over 93% of them took between weeks to more than a month to evaluate an investment.

Thus, an entrepreneur with an investment proposal had a short period of time to convince a private equity manager on the investment attractions

of his or her company. Thus, it is important that the firm is well known in the marketplace before approaching a private equity manager.

How should an entrepreneur approach a private equity manager? The study showed that the most frequent source of an investment proposal was referral by a trustworthy source followed by direct approach by entrepreneurs. Furthermore for all cases the methods used by Malaysian private equity managers to asses an investment was meeting with the entrepreneur (100% respondents), reading the Business Plan (94%), reading specific market research reports (75%), and seeking advice from personal network of contacts (63%).

Table 2-2 shows the main activities of Malaysian private equity managers in sourcing and assessing investment candidates.

Table 2-2: Sourcing and Assessing Investment Candidates

Investment Origination	**% of Private Equity Managers**
Referral by a trustworthy source	75.0
Direct approach by the entrepreneur	68.8
Networking event where entrepreneurs present their business plan	68.8
Informal networking groups of private equity managers	62.5
Other private equity managers where joint investments have been made	56.3
Affiliated private equity managers	50.0
Industry conference	43.8
Networking among private equity managers' key contact	37.5
CEO's of companies in private equity managers' portfolio	37.5
Senior executives of companies previously funded by the private equity managers	18.8

Investment Assessment	
Meeting with the entrepreneur and management team	100
Reading the Business Plan	93.8
Reading industry specific and market research reports	75.0
Seeking advice from personal contacts	62.5
Research reports prepared by staff of the private equity company	62.5
Contacting references provided by the entrepreneurs	50.0
Seek advice from a consultant paid by the private equity managers	50.0
Comparing this investment with another investment made previously	43.8

Table 2-2 indicates clearly that private equity managers depend on a close network of contacts to help secure investment potential. Thus, entrepreneurs should identify closely these sources of referrals that private equity managers use frequently.

Business Plan

While the management team is the most important criterion for investment decision making, the Business Plan serves an important tool for entrepreneurs to communicate the potential of an investment. However, I will not put too much emphasis on the Business Plan as my experience shows that my most successful investments were companies that were managed by hard working entrepreneurs who were often not good communicators. I am more concerned with "smooth talking so-called entrepreneurs with impressive Business Plans".

My study shows that Malaysian private equity managers placed high importance on the Business Plan which must contain the following salient sections.

Section	Rank of Importance
Executive Summary: Clarity of the Business Plan	1
Financial Projection: Realistic	2
Business Model: Clear and Convincing	3
Market Analysis: Detailed and Concise	4
Customer Need Analysis: Detailed and Concise	5
Competitive Analysis: Comprehensive	6
Product Analysis: Detailed and Broad	7
The Content and Structure of the Business: Very Well Organized	8
Biographies of the Business Plan: Detailed	9
Facts and References Used: Trusted by private equity managers	10

Exit Strategy and "Burn Rate"

Private equity managers also require a clear exit strategy from an investment to allow them realize a return on their investment. When the investment is a start-up company, they will also place importance on the time taken by the company to achieve "positive cash flow". The private equity managers would like to know how much the company would require money during this period. The amount of capital to be contributed by the private equity managers is usually called the "burn-rate capital".

The smaller is the "burn-rate capital", the better the investment potential to the private equity manager. Normally, private equity managers are willing to support the "burn-rate capital" once agreed with the entrepreneurs but are reluctant to invest more capital beyond the initial agreed "burn-rate capital".

Conclusion of the Study

The studies undertaken by my MBA students provide greater insights into how Malaysian private equity managers make their investment decisions.

Understanding the process and criteria of investment decisions are beneficial to entrepreneurs seeking funds from the Malaysian private equity managers. The high rejection rate of Business Plans by private equity managers may be partly due to the fact that entrepreneurs are not providing the information.

Chapter 3 deals with the preparations required by the entrepreneurs before they approach the Malaysian private equity firms.

Chapter 3

Are You Ready For Private Equity Investment?

CHAPTER 3

Are You Ready For Private Equity Invesment?

Approaching Private Equity Managers

Entrepreneurs have often asked me when they should invite private equity managers into their companies. My answer has always been, "Are you willing to share the rewards of the company with them".

When a private equity manager decides to invest in a company, he or she has evaluated its prospects thoroughly, and the private equity manager is willing to assume an investment risk in the company. The private equity manager is making a commercial decision and he or she expects to make money on this investment.

Depending on the amount of investment made and the percentage of shareholding represented by the investment, a private equity manager will always require a representative on the Board of Directors of the company. Thus, the company will have an outsider or outsiders on the board of the company when there was none before. In addition, a private equity firm expects the company to have proper corporate governance and a good flow of information about the operation of the company.

In many examples, I often helped the entrepreneur to improve the information flow and prepare the agenda for the Board of Directors' meeting. Generally, private equity managers are not interested in co-managing the day-to-day operations of a private company in which they invest. They are more interested on matters that can affect the growth of the company and the business strategies to achieve the growth.

A good private equity manager will nominate a person with the right experience to represent the firm on the Board of Directors of companies. The entrepreneur will be consulted by the private equity manager before appointing an individual on the Board of Directors of the company.

Once a company has a private equity firm as an investor, an entrepreneur can exploit the association with the private equity company. Among the positive aspects of the association include the following:

- An investment by a private equity company signals to others such as banks, suppliers and buyers that the company has passed the stringent investment criteria set by a private equity company.

- The company is destined for growth and the private equity company will only invest and inject capital into growth firms.

- The company can take advantage of the business networks of the private equity managers. Other companies owned by the private equity managers may be able to help in expanding the business of the company.

Thus my views are that an entrepreneur may consider an investment by a private equity firm if he or she is interested to have an outsider to help in expanding the business in exchange for a stake in the company. Please be prepared, as the corporate union between the entrepreneur and the private equity manager will require certain sacrifices between the various parties related to the company.

The Strategy of Approaching a Private Equity Manager

Based on my experiences, many entrepreneurs are not ready when they approach private equity managers for capital. Just like sitting for a major examination, entrepreneurs must get themselves and their companies prepared when they want to approach a private equity manager. How do you get yourself and the company prepared to approach a private equity manager?

An entrepreneur is prepared when they have achieved the following:

Corporate-Structure Ready

An entrepreneur should make sure that the corporate structure of the private company must be "ready and attractive for private equity investment". These include the corporate structure, directors and shareholders. When a company intends to approach a private equity manager for investment, we will like to see whether the paid-up capital is significant and shows a positive level of shareholders' fund. A large amount of negative shareholders' fund will not be viewed favorably by the private equity manager.

In many instances, I would like to see the management team has a combination of the entrepreneur's family members and professionals.

The accounts of the company must also be in order. A well-known accounting firm as the external auditor of the company should be appointed. This will be viewed positively by the private equity manager.

Proper Facilities and Factories

Generally, a private equity manager will not invest in a company that does not have proper facilities and factories. A company with a factory located in an illegal premise will not attract interest from a private equity manager.

Management Team

A company should have a good management team when it wants to approach a private equity company. Although private equity managers do not mind having a number of family members in a company, the management team should also comprise other qualified professional staff.

A private equity company will also place an important factor on the leadership and entrepreneurial qualities of the key management team, especially the main entrepreneurs.

Track Record of Solid Revenue and Growth

A private equity firm loves to invest in a company that has registered a solid revenue and revenue growth. What is good sales revenue that a company should have before approaching a private equity manager?

This largely depends on the investment strategy of the private equity company. Private equity firms love to invest in companies which have good sales track records. Typically, the sales of a company which I would invest should be at least RM15.0 million for the latest financial year. Our successful private equity investments are mainly those companies that have achieved turnover of more than RM20.0 million per year. Obviously, the higher the revenue, the more attractive the company is to a private equity manager.

Rapport with Private Equity Managers

Like everything in life, relationships count! Once you have decided to approach private equity managers, it is important that entrepreneurs develop a good rapport with them. Private equity managers are often invited to speak at various industry conferences and these are opportunities to meet these executives.

Private equity managers are frequent visitors of industry exhibitions and conferences where they source and identify potential companies to invest in.

In many examples, I met my successful entrepreneurs in various industry exhibitions which I followed their progress over many years. When these companies have expansion plans, they would normally meet the private equity managers whom they have developed a rapport over many years.

Among several reasons entrepreneurs seek funds from private equity firms include the following:

- Avoid bank borrowing in order to reduce directors' exposure.
- Expand factory facilities and working capital.
- Sell shares to realize investment return.
- Enhance corporate profile by inviting established private equity companies.
- Sell the company to pursue other personal interests.

For private equity managers, they know there are many companies that are seeking funds for various reasons. However, they are looking at a few companies that they believe will have significant future growth.

Get Yourself Noticed

A beautiful maiden gets noticed! A company seeking a private equity fund should try to get noticed by private equity managers. A company that is covered in a newspaper such as getting an industry award will be attractive to a private equity manager. I would ask my investment manager to be in touch with the company if it was highlighted in a newspaper or it's entrepreneur interviewed.
A company seeking private equity fund can use various venues such as conferences and seminars to highlight and promote his or her company. We are sure that one of the attendees of the seminar will be a private equity manager.

Today, a good company website is a must as a promotional tool. This will allow a private equity manager to surf the website and at the same time, allow the private equity manager to monitor the progress of the company.

Stages of Private Equity Investment

Once a company gets noticed, there will be many stages before a company receives money from a private equity manager.

Typically, a private equity company follows various stages of actions before the disbursement of fund into a private company. These stages are as follows:

- Calculation by the potential company that cash is required for expansion, development or buying out existing shareholders.
- Preparation of a Business Plan and funding proposal.
- Initial approach by the private equity manager.
- Private equity manager's preliminary consideration followed by investigation (meetings and visits).
- Indicative offer letter-commonly known as the "term sheet".
- Discussions of the terms of investment within the private equity company.
- Acceptance of the indicative offer.
- "Due diligence" process.
- Study of the results of due diligence, and indicative offer confirmed or modified.
- Investment committee proposal of the private equity company and indicative terms approved, modified or rejected.
- Issue of full offer letter by the private equity company.
- Formal acceptance by the entrepreneur subject to legal stages.
- Legal stages between lawyers of the private equity company and the entrepreneur.
- Completion meeting.
- Private equity company transfers money.

- Private equity representative joins the Board of Directors.
- Everyone lives happily ever after!

The preparation of the legal agreement is normally discussed between the private equity manager and the entrepreneur. At the same time, my most important task is to develop a personal rapport with the key members of the firm's management team. This is because in many instances the investment into a potential company could fail because it is not supported by key members of the management team.

Finalizing an Investment Deal

The last stage of negotiation between an entrepreneur and the private equity manager is to "put everything on paper". This means that their respective lawyers will prepare a document to effect the sales of shares of the company to the private equity manager.

A good lawyer is a must so that the agreement to be signed between the entrepreneur and the private equity manager will provide a number of protection clauses in case of disputes that could arise in the future. Among the clauses in the agreement that the entrepreneur should be very particular include the following:

- The amount of money involved in the investment and the schedule of payment: In many instances, the payment to be made is contingent on the entrepreneur meeting specific conditions. The entrepreneur should make sure that the conditions are clear and can easily be met.
- The involvement of the private equity manager in the decision-making process of the company: The private equity manager will be requesting their representatives to be invited as members on the Board of Directors of the company. The number of their representatives is dependent on its shareholding. My practice is that we will have one representative per every ten percent shareholding.

In addition, for a large company, a private equity manager will ask for specific committees to be formed for the purpose of ensuring that the interest of the private equity manager is protected. The private equity manager would like to have certain level of control of such matters such as the limit on capital expenditure, salaries and benefits, and hiring of key managers.

Thus, entrepreneurs must be very careful on the extent of the request of the involvement of the private equity manager on the decision-making process of the company. Please be prepared to negotiate hard on these following clauses:-

The procedure of terminating the involvement of the private equity firm if the investment turns sour: The private manager expects to exit his investment in the company within a certain period of time. In my experience, if such investment exit is not achieved, the private equity manager will require that the entrepreneur to repurchase the shares held by the private equity manager at an agreed price formula. An entrepreneur should know and agree to this important clause. In effect, this clause gives the “first right” to the entrepreneur to repurchase the shares from the private equity manager.

The procedure to settle disputes: The private equity manager expects to make a significant investment return on his/her investment and a proper procedure to settle disputes among the shareholders is important. The entrepreneur must recognize that the private equity manager normally does not hold controlling interest in the company. Thus, the private manager expects a clear procedure in order to settle disputes.

Businesses Which are Not Attractive to Private Equity Managers

There are some businesses which are not attractive to private equity managers no matter how outstanding the potential return in the “Business Plan”.

My experiences show that private equity managers will not invest in

“sole enterprises”. We normally ask the entrepreneur to incorporate a “Sdn. Bhd.” before we would evaluate the “Business Plan”. We have had successful investments in former sole enterprises due to the strengths of the businesses.

Private equity managers will not invest in companies which are located in illegal factories and premises. We would encourage these companies to relocate to a proper location before making an investment.

Private equity managers do not invest in certain sectors depending on their business restrictions. Malaysian Government-backed equity firms do not invest in “non-halal” private companies.

Private equity managers also do not invest in companies that are “not in fashion” during a particular period of time. Currently, private equity managers will be reluctant to invest in companies that are involved in manufacturing of computer components due to their perceived low profit margin. Instead, they will like to invest in companies which are involved in the oil and gas sectors because of their perceived growth.

Many private equity companies specialize in investment in specific sectors. Thus, they will not invest in companies outside their specialized areas.

Our advice to entrepreneurs is that you should meet as many private equity managers as possible and tell them about your business in detail. These meetings will also help you to develop a good rapport with the individuals in the private equity company.

Understanding the Expectations of Private Equity Managers

The topic of this Chapter is “Are you ready for private equity?”. The entrepreneur must recognize that the private equity manager is interested in a company that has a significant potential to grow if nurtured carefully through injection of new capital and business expansion. The private equity manager only selects the company after careful evaluation.

In order to attract capital from a private equity manager, the company must have the desirable characteristics demanded by the private equity manager. It is important that the entrepreneur understands these desirable features and incorporate them into the company. The entrepreneur must plan and implement the appropriate strategy to ensure that the company is "ready for private equity".

Grooming for Private Equity Investment

In order to solicit the highest price from a private equity firm, the company will have to undergo a specific period of corporate grooming. Ideally, the grooming process takes place at least two years before the sales of the equity. Among the main areas for grooming the company include:

- Improving the earnings of the company.
- Polishing plant's operation and layout.
- Tidying-up financial reporting, corporate information and reporting.
- Providing a peace of mind to the private equity investors

Improving the Earnings of the Company

An investor is interested in knowing how much the business may be expected to make going forward, as they are essentially buying the future streams of cash. The future cash streams should be growing with less volatility. An important measure of the earnings of the company is the profit and loss and cash flows. The accounts must be established as accurate as possible so as to reflect the true picture of the performance of the company.

As the company grows, many businesses acquire a variety of peripheral areas of activity arising out of their core business. Some of these additional activities may be significant contributors to profits, others may be more marginal. If a business has a large variety of marginal areas of activity that may confuse the strengths of the company, it is

advisable to shed these marginal activities and to focus only in the core areas of the company.

In addition to a clear profit and loss account, the balance sheets of the company should be cleaned-up as a part of the grooming process. The longer term issues involve identifying assets such as land and buildings which should be removed from the balance sheets prior to the sale.

In the medium term, the entrepreneur needs to review liabilities which may cause problems to an investor's due diligence of the company. These liabilities include shareholders' loans and advances and inter-company trading activities.

The due diligence process will also likely raise the issues of doubtful debts and slow moving or damaged stocks, and these should be written off.

Polishing Plant Operations and Layout

The way the factory, offices, plant, equipment and stocks are kept will make a significant impression on private equity managers when they first visit the business premises. Not only about the plant and equipment itself, but also about how efficiently the business is operated and how reliable the controls are likely to be.

The purchase price of a company will be influenced by the confidence of the private equity manager on the ability of the company to sustain future cash flow streams based on existing factory layouts. There is a major difference in the perception of the business value between a plant that is clean and crisp in appearance compared to one that is in a mess.

Tidying-up Financial Reporting, Corporate Information and Corporate Reporting

Since the entrepreneur wants the sale to go ahead as smoothly as possible with the minimum of surprises and ammunition for the purchasers to reduce their offer prices as a result of items found during due diligence,

the first thing to do is to ensure that the company's books and records are tidy and up-to-date.

As the investor is broadly interested in the future underlying profits of the business, the more certain the future results are, the better the entrepreneur is able to justify a higher price for the company. All relationships with customers and suppliers, wherever possible, should have contractual agreements.

Providing a Peace of Mind to the Private Equity Investors

When looking to groom the business for private equity investment, try to put yourself into the prospective investor's position. When the private equity investors are assessing the business, what they are most worried about are risks that arise out of the weaknesses of the company. Therefore, the entrepreneur needs to consider the business critically to identify the weakest parts of it for the most concerted action.

The private equity manager will need to be made comfortable with the accounting and control systems. The private equity manager also will need to be aware of the business liabilities and these are recorded in the company's books.

In order to deliver the projected income of the business, a good management team is needed to manage the business. Thus, a vital part of the business grooming process is building an adequate management team and information systems.

It is to be noted that the grooming process performs two vital functions. First, it is designed to make the business as interesting and as attractive to a prospective private equity manager as possible. This is to ensure that the valuation of the business is the highest possible and the private equity manager is keen to invest in the company. Secondly, combined with a "mock due diligence" exercise, the grooming process is designed to ensure that business valuation thereafter, including the due diligence carried out by the private equity manager, goes smoothly,

and certainly gives rise to no unpleasant surprises or grounds on which the private equity manager can seek to negotiate the business valuation downwards.

Private Equity Selection: The Entrepreneur's Choice

A few key aspects of the future relationship between the entrepreneurs and the private equity manager must be investigated by the former before an investment transaction is finalized and consummated. Among these aspects are:-

- The style of the private equity manager that suits with you. A typical private equity manager will either adopt the "hands-on" style or the "hand-off" style.

- The private equity manager's attitude towards the investment transaction. For example, an entrepreneur may require a transaction involving the purchase of existing shares and injection of new money but is not accepted by the private equity manager. Some private equity managers are well known to be hard negotiators!

- The exit aspiration of the private equity firm. The entrepreneur must be fully aware of the time horizon of the private equity firm. A long time horizon may not be suitable for a particular stage of your company. You may want a private equity manager who is willing to let you re-purchase the private equity's investment when you have the financial capacity.

- The private equity firm's financial stability and the availability of follow-up finance. An entrepreneur should choose a private equity that has a strong fund size, and the private equity can make follow-up investment if required to take advantage of business opportunities. The entrepreneur should avoid a private equity which is in the phase of harvesting its investments as

this may indicate that the private equity firm may not be able to make follow-up investment when required.

- The private equity management's track record, both as individuals and as a team. The entrepreneur should choose a private equity firm that has made several investments in your business sector. You can ask how many successful investment exits he or she has achieved.

My Summary of Strategies of Getting Engaged with Your Ideal Private Equity Managers

The most successful private equity managers understand when to get into and when to get out of an investment; that is which risk to accept and which one to avoid.

Your Business Plan and your oral presentation must provide the right answers to a number of questions that will be asked, whether or not they actually verbalize these questions:

1. How much can I make?
2. How much can I lose?
3. How do I get money out of the deal?
4. Who else in the deal?
5. Who says you are good?

How Much Can I Make?

Your Business Plan helps the private equity manager to answer this question. The essence of the Business Plan lies in answering the question of return on investment or ROI. The private equity manager wants to know how much money the entrepreneur projects that the private equity manager will make in three to five years. The target return varies from one private equity manager to another. A typical private equity manager who invests in mezzanine-stage investment expects a return of at least forty percent over a period of three to four years. A private equity

manager who invests in early-stage project expects a higher return of at least eighty percent.

How Much Can I Lose?

This is the second question asked by the private equity managers and again is answered by your Business Plan. The answer lies with the structure of the proposed equity deal, the number of representatives on the Board of Directors of the company, and the terms of investment given to the private equity manager.

How Do I Get My Money out of the Proposed Deal?

With this question, the private equity manager is asking the entrepreneur to take him or her out in three to five years via an initial public offering, acquisition by a large company or a buy-back of the private equity's investment.

A private equity manager generally asks for an understanding with the entrepreneur upfront that an exit will be sought within three and five years after the private equity firm makes the investment.

Who Else in the Deal?

The private equity manager would like another company to be involved in the transaction. Is there a bank, or a finance company that is at risk to the company?

The private equity would like to have another entity with him or her because if the company is in a business difficulty, there is another investor or entity that can take an active role in saving it.

Who Says Your Company is Good?

The private equity manager wants to know you, your management team and your business. Is your company well regarded by your competitors,

suppliers and buyers? Have you been recognized as a successful entrepreneur by winning industry awards? The entrepreneur must get ready with five to fifteen references.

The Next Step of Private Equity Investment

When you are private equity-ready, an entrepreneur will want to know what is the worth of his/her company. Valuing a company, especially a private company is a complicated exercise.

Most entrepreneurs will have a rough idea of the worth of his/her company. This value may be arrived at on many assumptions that he/she believes would be applicable to the company.

The private equity manager will also has a view on the value of the entrepreneur's company. This is based on various assumptions of the business and also on the performance of comparable companies in the same sector.

My advice to entrepreneurs is that valuation of a private company should be left to the professional as it is a complicated exercise. Chapter 4 is an introduction to the various techniques used in valuation of a private company. The entrepreneur should get a business valuation report done and negotiate from there!

Chapter 4

Knowing the Worth of Your Company

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What is Your Business Worth?

The private equity manager and the entrepreneur are both keen to know what is the business worth. Business valuation of a private company is a combination of the art and science and, how much the private equity manager (the buyer) will be prepared to pay is dependent not only on the nature and finance of your business but also on the nature and the finances of the buyer.

The private equity manager is a financial investor and the main expectation of investing in your company is to realize significant return on investment from participating in the business. This is unlike an industrial buyer which invests or purchases not only for financial reason but also for strategic reasons. Thus the private equity manager expects to exit from the business within a specific period with a significant financial return.

It is to be noted that a business is really worthy when someone is prepared to pay for it. Notwithstanding, a valuation of a business can

help an entrepreneur in the following:

- Identifying assets which you would rather keep than include in the investment transaction with the private equity manager.

- Identifying financial risks in the existing business which could be shared with the new investor. These financial risks can include personal guarantees and overdraft bank facilities.

- Identifying how best to "groom" the business so as to secure the best value for the business.

- Understanding the range of possible valuations placed on the company by different investors or purchasers and the basis they and their advisors will arrive at these. Other than the private equity firm, the business could be sold to interested buyers such as industrial firms.

- Ensuring that you have a realistic view of the value achievable by the current business.

- Helping you arrive at the price of the business you are not prepared to agree (your minimum price). This price will never be disclosed to the purchaser or the private equity manager.

Whatever valuation method being used, the entrepreneur should set a reasonable target price for the business. Setting a ridiculously high price can be a major error as it may scare the private equity manager from investing in the company. It may signal that you are not interested in entering into a transaction. It may well sour your relationship with the private equity manager.

How Should You Value Your Company?

Interestingly, the failure of a private equity company to invest in a firm is often due to a large difference on the value of a company considered

by a private equity manager and its value placed by the entrepreneur. Fortunately, there are many books that can help entrepreneurs understand these valuation techniques and they are listed at the end of Chapter 4.

An example of the evaluation of a hypothetical company is also included in the Appendix.

Basis of Business Valuation

Shannon P. Pratt, the author of many books on valuing business describes in the simplest sense that the theory surrounding the value of a business depends on the future benefits that will accrue to its owner. The value of the business interest, then, depends upon an estimate of the future benefits and the required rate of return at which those future benefits are discounted back to present value as of the valuation date.

He further stated that while there is general acceptance of a theoretical framework for business valuation, translating it into practice in an uncertain world poses one of the most complex challenges of economic and financial theory and practice.

Business valuation is generally conducted by a business appraiser. In Malaysia, business appraisers can include accountants and consulting companies specializing in business valuation. One such company is my own, Bison Consulting.

The methodology used for business valuation is similar to the valuation of real estate or properties. The most common broad approaches used to value a private company are as follows:

Asset Valuation	Total of the value of all the individual assets including tangible and intangibles.
Market Valuation	A comparison against the price achieved for other businesses that have sold recently.
Discounted Cash Flow	Takes estimates of cash flows to be generated by the business in future years and uses accounting and financial techniques to discount back the cash flows to a present value.

Return on Investment	Essentially creates ratios of either the return (the earnings that the purchaser will achieve) divided by the price they pay for the business or the price/earnings ratio (which the price they pay for the business divided by the current earnings stream) which shows how long it will take to repay the investment.
Sector Specific	Particular sectors will have their own rules of thumb about how to value a business based on the characteristics of the business.
Basic Multiple	As a rule of thumb business with certain characteristics will be valued at a certain multiple of earnings.

Most business valuation will need to be undertaken by professional appraisers. However, it is useful for the entrepreneur to have an understanding of how each valuation is arrived at, how it is used and its relative strengths and limitations so as to be able to deal with your appraiser.

Adjustments of Earnings

As most business valuations are based on estimated future earnings, one thing to appreciate is that the business appraiser will always make significant adjustments to the past earnings or projected future earnings statements (profit and loss account) in arriving at the business valuation. This is a normal part of the process of business valuation.

Business owners, particularly in family-owned companies, are not normally motivated to manage the firm’s profit and loss to achieve the highest possible levels of profits. Instead, they are generally motivated to manage their business and earnings in such a way as to minimize the tax payable.

It is important that before undertaking a business valuation exercise, the business must undergo a “grooming process” for a period of at least two years. This is to demonstrate the true profitability of the business. If this means paying a higher level of tax than usual, the entrepreneur can rest assured that the sale price of the business to be achieved will probably be based on a multiple of earnings which allows the business owner to recover more money than the extra tax payable.

The business appraiser will be looking to adjusting the profit and loss statement in order to show as high a level as possible of underlying sustainable profit for valuation purposes and to persuade the purchaser that they should pay a high valuation for the business. Typical adjustments include salaries for owners and family members working in the company and expenses which are not related to the business.

In order to obtain a realistic picture of the profit and loss account of the company, all such elements will have to be eliminated and replaced where appropriate with reasonable open market cost estimates.

Valuation Approach: Asset Valuation

The value of the assets of a firm is often a logical place to start when valuing a business. In the case of the business which is making losses or it had failed, it is normally the fundamental basis on which business valuation is based. This is because if the business is loss-making, it does not have a stream of profit to multiply or project.

There are essentially three bases of the valuation of assets. These are book value, going concern and forced sales value.

Book Value

Book value represents the total value of all the assets (net of the relevant liabilities) as stated in the company's account. It is also referred to as net asset value or net worth. Because book value of the assets in the company's balance sheet is based on their purchase price, there will be some "significant" assets of the company which may have no value allocated to them at all. These assets include intellectual properties such as brands, patents, trademarks, designs, copyrights and contracts.

Some businesses have very few physical assets and they depend entirely on their staff. In these types of businesses, the difference between the value of the business and the value of the net assets will be significant. As a result of these problems with valuation of assets, businesses

with reasonable performance will be expected to be sold for a value higher than the book value of their assets. The accounting term for the difference between the value of the assets and the value of the business is the goodwill of the business.

For these reasons, the book values are rarely used for valuing a business although the price obtained for the business as a multiple of the book value is sometimes used as a cross check against similar calculations for other businesses in the same industry that have been recently sold to ensure that the price obtained is in line with those businesses.

Going Concern Value

This is a valuation of the business assets on the assumption that they are all to be sold together as a trading business. It therefore takes into account how much someone will be willing to pay for the portfolio of assets given the ability to earn money.

Forced Sale Value

This is the type of valuation that a liquidator would obtain when considering to sell the assets of the business that has ceased trading. It represents a breakup valuation of the assets so that there is no value to be obtained by their synergy as a package of assets with which to conduct a trade.

Valuation Approach: Market Valuation

This approach is similar to valuing a house. Accordingly, with many businesses, by looking at the trade press or by contacting professional appraisers specializing in the specific industry, we should be able to identify a number of businesses that have been sold in the industry and the prices achieved in the recent past to allow us to judge the basis of valuation.

An alternative approach is to consider comparing the business valuation to those publicly traded businesses in the industry, on the basis of the

ratio of the price to earnings or P/E ratio. This approach should be treated with extra caution. As for the shares of these businesses are publicly traded, there is a ready market for them. These shares therefore have “liquidity”.

For a private company, the business is unlikely to attract the sort of price earning multiples that a similar public company would. Given the number of assumptions that will have to be made in terms of determining an appropriate P/E multiple to use to come up with a valuation, a P/E ratio approach to valuation is usually considered too subjective, particularly when compared with the discounted cash flow approach.

Valuation Approach: Discounted Cash Flow

Discounted future cash flows are used as a way of estimating what somebody is prepared to pay now for the future streams of cash that is going to be generated by having bought a particular asset, business or project.

For the purpose of valuing businesses, a theory called the capital asset pricing model generates the cost of equity for the purchaser based on the “risk-free“ rate of interest that someone requires for investing their money rather than spending it times a risk factor for investing in a particular sector, known as beta, which is generated by looking at returns generated by quoted companies on the stock exchange.

By analyzing the debts used by the company, we also generate the cost of debt of the company. Based on the capital structure of the company, a discount factor called weighted average cost of capital (WACC) of the company is computed.

Under the discounted cash flow approach to valuation, the value of the business to a purchaser is the total of the future discounted net cash flows. The future cash flows include the cash flow generated over a projected period and the terminal value of the business beyond the projected period.

One of the disadvantages of the discounted cash flow technique is that

the appropriate discount rate for the valuation will be the purchaser's weighted average cost of capital. Obviously the WACC will vary from purchaser to purchaser and therefore we will have to make an assumption as to what the purchaser's appropriate discount rate will be in order to calculate a discounted value.

Nevertheless there are many advantages to using a discounted cash flow approach in that it forces a rigorous and quantified examination of a variety of issues that will be relevant to the business going forward.

Valuation Approach: Return on Investment

If purchasers are looking to buy a business, they are presumably doing so on the assumption that it will make profit on their investment. The return on investment is a more crude measure of business valuation. The second measure is payback period, which is again a crude way of measuring risk. Obviously the shorter the payback period, the quicker the purchaser will be "seeing" his or her money back.

Valuation Approach: Sector Specific

Many trades, particularly those where there are a relatively large number of small businesses with therefore a constant high number of such business sales during any business year, tend to develop their own specific basis of valuation and normal deal structure. For example, a professional firm can be sold on the basis of a multiple or gross recurring fee.

Valuation Approach: Earning Multiples

The most commonly used basis of valuation is the multiple of earnings approach. This is calculated simply on the basis of earnings/profits (before interest and tax, known as EBIT) times the appropriate multiple. The level of multiple to be applied is then obviously a matter of judgment, given the strength of the business and the current economic environment.

The worse is the competitive position or reliance on strong management, the lower is the multiple that should be expected. The clearer the competitive advantage and steadiness of the earning stream, the higher the multiple that would be used.

Comparison of Valuation Approaches

The business's value is what somebody is prepared to pay for it; and what they are prepared for generally is a future stream of profit and cash. The only question is therefore, how much money they are prepared to pay for that future income given its apparent degree of risk and reliability?

The advantages and disadvantages of the various valuation approaches are summarized as follows:-

Valuation Approach	Advantages	Disadvantages
1. Asset value: the value of all the assets, less the value of liabilities on either a "book" or a professionally valued basis	Going concern and forced sale values provide "cover" against worst case valuation	Book values are "meaningless" and asset valuations do not reflect value of the trading business being bought
2. Market value: the going rate for a similar business	Easily understood comparison	Difficulty of getting the relevant reliable, comparable information
3. Discounted cash flow: the value of the future annual cash flows, discounted back to the present value in term of cash today	Makes everything explicit and qualified	Finding the correct WACC and the underlying uncertainty of future cash flows
4. Return on investment: the profit earned in future years expressed as a percentage of the investment required	Easy comparison between investment opportunities Not cash based	Not cash based and dependent on projection of future earnings
5. Sector specific: standard basis used for a particular industry or sector	Common basis for comparison	Do not reflect the individual circumstances of the business and its properties
6. Multiple of earnings: profit times a "multiple"	Subjective but readily understood	Not cash based and relies on a projection of future earnings

Other Factors that Affect Value

The various valuation approaches will allow an entrepreneur to establish the worth of his or her company. In many instances, the private equity manager will also consider other qualitative factors to arrive at his or her valuation of a company.

An important factor is the quality of the management team. Typically, a private company is dependent on a few key individuals. Their products and services can also be narrow and that will increase potential risks to future benefits or cash flows of the company.

Additional factors to consider in various cases include R&D efforts, industry position, quantity and quality of asset base relative to competitors, and the quality and relationship with its workforce. These factors will be considered to the final valuation of the company.

Discounts to Business Value: Minority Interest and Shares Illiquidity

The valuation approach can assist an entrepreneur to establish the worth of his or her company. However, a typical private equity manager will demand a discount from the valuation due to the following concepts:

Minority interest discount: Generally, a private equity company will invest less than 49% of the equity of a company. The rest of the equity will likely be held by the management team. The rationale of the investment strategy of the private equity company is that by allowing the management team to maintain a controlling interest, the key managers will have significant financial incentives in the future success of the company.

The private equity company is only a minority shareholder in the company. This type of ownership is often referred in the valuation literature as a minority interest or minority ownership interest. It is sometimes referred to as non-controlling ownership interest. The value

of a non-controlling interest can sometimes be calculated by applying a discount to the value of a controlling interest. Empirical evidence shows that the discount to reflect minority can be as high as 40%.

Shares illiquidity discount: All other things being equal, an ownership interest in a business is worth more if it is readily marketable. The ownership interest is worth less if it is not readily marketable. This is because investors and entrepreneurs prefer liquidity to illiquidity.

Therefore, in finalizing the valuation, the business appraiser will have to identify and quantify the valuation adjustment associated with the illiquidity of the private company and the lack of interest in the ownership interest. Many empirical studies have supported the need for this adjustment when a private company is involved. What is the typical adjustment factor?

Based on our literature review research on this subject, we believe the most appropriate value to use for the average private equity discount is 20%. This private equity discount is based on empirical studies in the US, which has a more liquid market for private equity transactions. On the other hand we can argue the number of attractive companies is fewer in Malaysia than in the US which means that higher liquidity for such companies.

The Final Valuation Method

How does a business appraiser arrive at the final valuation when a number of valuation methods are available? A business appraiser will usually undertake a weighting of valuation method results. Unfortunately, there are no scientific formulas or specific rules to use with regards to the weighting of the results of two or more valuation methods.

The final value estimate should typically be a number within the range of value indications derived from various methods used in the valuation analysis. The final value estimate may be a number indicated by one of the valuation methods. Or, it may be another number from within the

indicated range of values. The final value opinion regarding the business enterprise should be derived from the business appraiser's reasoning and judgment of all factors considered.

How Private Equity Manager Sets a Valuation to Target Company

The private equity manager typically recommends an opening range of valuation to a target company based on a valuation approved by the Investment Committee of the private equity company. The private equity managers are allowed to offer to the entrepreneur within such a range of value. If the entrepreneur demands a higher price than the range of value approved by the Investment Committee, the private equity manager must go back to the Investment Committee for new offers.

I generally enjoy the process of putting a value to a particular company and then going into the bargaining process with the entrepreneur. When a private equity manager agrees to put a value to a particular company, an entrepreneur should be ready for a hard bargaining as at this stage the private equity company has signified its interest in that company.

List of References on Business Enterprise Valuation

There are many books written on valuation techniques. However, I encourage entrepreneurs to read the following books which provide valuable techniques on the valuation of private companies.

1. *"Investment Valuation: Tools and Techniques for Determining the Value of Any Assets"* by Prof. Aswath Damadoran, published by John Wiley & Sons, Inc. The book is academic in nature and well written for MBA students and other finance professionals. If you can read and understand the whole chapters of the book, you can definitely become an expert on valuation of assets and companies. The book costs about RM300.00 with more than 990 pages.

2. *“Valuing Business: The Analysis and Appraisal of Closely Held Companies”* by Dr. Shannon P. Pratt, published by Mc. Graw Hill. The author is a well known expert on valuation of private companies. The book is easy to understand but is also targeted at the valuation professionals. The book covers in detail the concepts of share control premium and illiquidity discount. The book costs about RM400.00 with more than 1,000 pages. This is an important reference for entrepreneurs who want to know the technique of valuing his or her company.

3. *“Venture Capital and Private Equity: A Casebook”* by Prof. Josh Lerner, published by John Wiley & Sons, Inc. The book is targeted for MBA students studying the private equity industry. This book is a must for my MBA students. There is a good chapter on valuation of private equity companies used by the private equity managers. The book costs about RM300.00 with more than 500 pages.

4. *“The Small Business Valuation Book: Easy-to-Use Technique that will Help You to Determine a Fair Price”* by Lawrence W. Tuller, published by Adam Media. The book is targeted at the general readers. I find this book useful for entrepreneurs who wish to value their small businesses. The book costs about RM60.00 with more than 300 pages.

While I recommend that entrepreneurs read these books, as the subject of valuation of private companies is complex, it is advisable to use an expert to value your firm.

Chapter 5

Grant Money for the Lucky Few

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Grant Money for the Lucky Few

Grant Money is "Free Capital for Companies"

The main focus of this book is on private equity as a source of capital for companies. Private equity is considered "expensive" as a source of fund to companies due the exchange of shares required with the injection of capital.

There are other alternative sources of capital which are less "expensive" or literally "free". One such source of "free capital" is called "grant money".

One of the key aspects of private equity is that the entrepreneur needs to sell parts of the equity of the company in exchange for the capital injected into the company. In effect, he/she is sharing the company with another shareholder who is a professional financial investor. The company is also being offered the skills and the financial strengths of the private equity company. Private equity is thus an important source of capital for companies without going to the bank.

In many countries such as Singapore, Taiwan, China, Europe and the USA, the Governments provide capital in the form of "grants" to assist

companies to develop new technologies and to support their development. "Grants" are essentially free subsidies from the Government and are available to companies which meet the conditions as prescribed by the Government. There is no equity to be exchanged with the "grant" provided. I call "grant" the "free money" and technically the "grant" is more attractive than private equity capital.

The Malaysian Government had also introduced a number of "grant schemes" to support the development of science and technology. Several government organizations and ministries are involved in providing "grant schemes". They include Malaysian Technology Development Corporation (MTDC), Malaysian Biotechnology Corporation, Ministry of Science, Technology and Innovation (MOSTI), SMI Corporation and Malaysian Venture Capital Bhd.

The "grant scheme" is given to a company based on the submission of a detailed report. Many professionals such as consultants, accountants and even lawyers are involved in helping firms to apply for these "grant schemes". Why is this happening?

This is simple to understand. As the "grant schemes" are free money, the money is essentially not required to be paid back to the government organizations that provide the "grant schemes". The professionals who are involved in submitting the application for the "grant scheme" can charge the firm high fees as the "grant money" is literally free. The amount of the "grant" can range from as small as RM50,000 to as much as RM10.00 million. How the lucky few have managed to secure these free monies from the Malaysian Government?

The major government organizations that are involved in the disbursement of the "grant schemes" are listed below:

Organizations	Type of "Grant Schemes"
Malaysian Technology Development Corporation (MTDC)	Commercialization of R&D Fund (CRDF): commercialization of R&D projects Technology Acquisition Fund (TAF): acquisition of new technology
Malaysian Biotechnology Corporation	Seed Fund: start-up costs in setting-up biotechnology companies R&D Matching Fund: funding R&D projects International Business Development Matching Fund: funding expansion into global market
Ministry of Science, Technology and Innovation (MOSTI)	eContent: funding development of content for entertainment, training etc. DAGS: seed funding for ICT community projects. TechnoFund: funding commercialization of projects in specific areas including acquisition of technology and construction of pilot facilities. InnoFund:funding innovation in small enterprises.
Multimedia Development Corporation	Funds for R&D
SME Corporation	Various funding programs to enhance technology etc.
Cradle Sdn Bhd	Cradle Investment Program: funds to develop business ideas

Techniques for Applying the "Grant Schemes"

I have significant experiences in the management of "grant schemes" when I was the CEO of MTDC. Companies could apply to MTDC for "grant schemes" under which the Malaysian Government through MTDC would provide 50% of the cost of acquiring technology or advanced machinery from overseas. The "grant scheme" was called technology acquisition fund and without doubt was popular with entrepreneurs.

The entrepreneurs together with their professional advisers developed the skills on how to fill the form required for an application. What techniques did they use to increase their chances of securing these "grant schemes"? Based on my experience in MTDC, the techniques which I recommend include the following:

- Study in detail the requirements of the application. Talk to the officers involved in evaluating and approving the "grant schemes".

- Obtain the list of projects that had been approved to receive the "grant scheme". Normally, a "grant scheme" will only be granted to the first project and not to a second similar application or technology. Be sure that your project is "new".

- Hire a reputable professional services firm that is familiar in the application of the "grant scheme".

- Submit additional information as required by the organization processing the "grant scheme".

Entrepreneurs should take advantage of overlaps between the various "grant schemes". For example, the entrepreneur can apply for the CRDF "grant scheme" managed by MTDC as well as apply the "TechnoFund grant scheme" managed by MOSTI. The entrepreneur needs only to modify the content of the application form specific to each organization.

As the "grant schemes" are very popular among companies, it is critical that entrepreneurs should be in close contact with the organizations managing the "grant schemes".

Filling Up of the Application Form of "Grant Schemes"

It is important that an entrepreneur understands the requirements of applying the "grant scheme". Typically, the application process will

involve the following steps:

Stage 1: Submission of application.

The company will be required to submit a complete application by using the format of the application form.

Stage 2: Review of the application.

Typically, the application form will be assessed by the management team of the "grant scheme" management company. The application will be evaluated based on its merits in line with the objective of the "grant scheme". The application will be approved or rejected by an internal evaluation committee. Additional information will be requested if required.

Stage 3: Final evaluation by "Approval Committee".

The application which is approved by an internal evaluation committee will be tabled at the "Approval Committee" of the "grant scheme".

Stage 4: Signing of agreement.

The successful applicant will be required to sign an agreement with the "grant scheme manager". The applicant will need to fulfill various terms and conditions before the "grant" money will be disbursed.

Standardized Application Form of "Grant Scheme"

The application form for the "grant scheme" has been standardized to ensure that the application can be assessed easily by the management team of the "grant scheme" manager. Many professional firms such as accountants, consulting firms, individuals, and even legal firms have specialized in helping private companies to submit the "grant scheme" application form.

An application form for CRDF which is a "grant scheme" managed by MTDC is shown in the Appendix Section. The CRDF has been one of the most popular "grant scheme".

"Grant Scheme" is Really Free Money from the Government

My advice to entrepreneurs is that they should take advantage of the various "grant scheme" available from the Malaysian Government. I have been informed that several companies have received several million Ringgits in "grant scheme" just by applying from different "grant scheme" management companies. The Malaysian Government has, however, tightened the rules and terms of the various "grant scheme" so that a company can only receive one or two "grant scheme" only within a specific period of time.

I also advise that the company applying for a "grant scheme" should appoint an adviser that specializes in the application of the "grant scheme". This is because an adviser is familiar with the staff of the "grant scheme" management companies and the requirements of the "grant scheme".

Many "grant scheme" are funds allocated by the Malaysian Government and thus are available to a "grant management company" in specific lump sums. The more popular "grant scheme" can be exhausted quite fast. Thus, entrepreneurs must submit an application for the "grant scheme" as soon as possible before the fund is exhausted!

My last word on the "grant scheme" is that if an entrepreneur does not apply, another entrepreneur will do.

Malaysian Government is Getting Tougher on Approval for "Grant Schemes"

When the "grant scheme" were introduced by the Malaysian Government in the early 1990's, the business community welcomed the initiative as the "grant scheme" were intended to support R&D and business

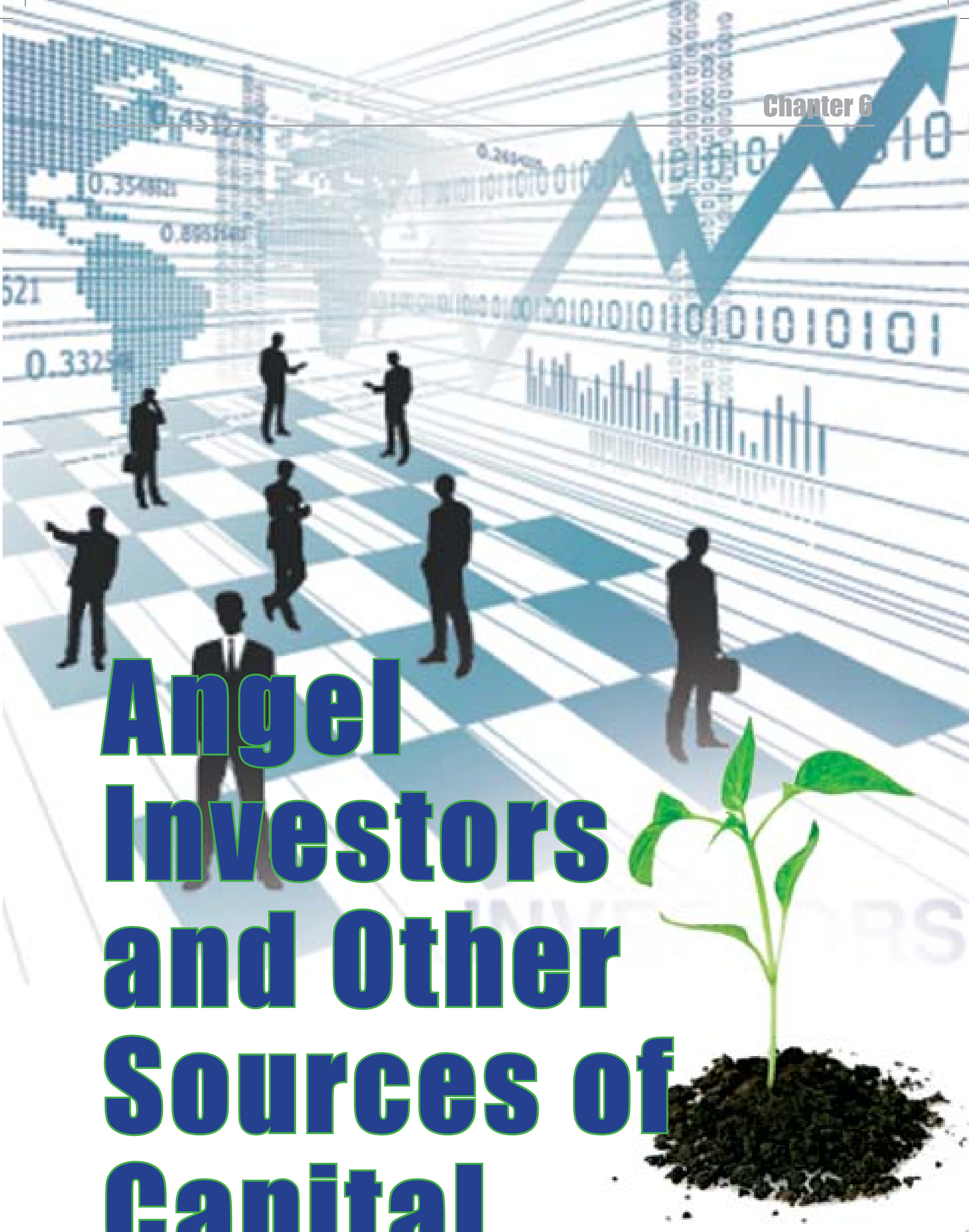
development activities. As the *grant schemes* were free money, many applicants had learnt the “art” of winning the “grant scheme”. Many successful applications did not actually spend the “grant scheme” on the intended purposes. Instead, the “grant scheme” were diverted to other activities which were not beneficial to the growth of the companies. There were many abuses on the “grant scheme” as they are “free money”.

Since then, the criteria for the application of “grant scheme” have been tightened with only stronger projects are approved. Coordination between the various managers of the “grant scheme” has been significantly improved.

Despite the new application guidelines for the “grant scheme”, it is possible for entrepreneurs with genuine proposals to secure them. The entrepreneurs will have to do a thorough homework and work with a reputable professional firm which is familiar with the “grant scheme” application process.

The Malaysian Government is likely to introduce new funds to assist companies in various business activities in line with the Malaysian Government’s aspiration of Malaysia to be a developed economy. Entrepreneurs should take advantage of these funding initiatives.

If a company fails to secure the “grant scheme”, there are other alternative sources of capital for companies which entrepreneurs could consider. This is explained in Chapter 6.



Chapter 6

Angel Investors and Other Sources of Capital

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Angel Investors

Before the Internet bubble in early 2001, I was introduced to the concept of angel investors in Silicon Valley, California. One of the most popular venues to meet the so called angel investors was at angel investors' investment seminars which were held during breakfasts at leading hotels in Silicon Valley. In these seminars, entrepreneurs and technical geeks were allocated about 10 minutes to "sell" their projects for funding by the angel investors.

Angel investors are also entrepreneurs who had also made a lot of money from selling their technology companies to bigger companies prior to the Internet bubble. They invested in new promising start-ups that could develop into huge companies in the short-term. Early investors would enjoy significant capital gain if the shares of the companies were sold to bigger companies after a series of capital injections.

I had been informed that several projects received several million Ringgits from these investors as a result of these 10-minute presentations. One of the extensive angel investor networks is Indus Entrepreneur Network. This Indus Entrepreneur Network was set up by successful

Indian technology entrepreneurs in Silicon Valley. These Indian angel investors provided early stage capital to Indian engineers and scientists who wanted to start up their own companies.

Since the Internet bubble, the activities of the angel investors have slowed down as many of the angel investors are nursing huge losses in their investments.

Angel investors are successful investors and entrepreneurs and thus they can provide both capital and management expertise to the new companies they back. They also take an active interest in the management of the company. The start-ups are generally too small to interest bigger private equity companies.

Finding Angel Investors in Malaysia

A few years back, a group of Malaysians established an "Angel Investors Club", which was a loose grouping of investors who wanted to invest in promising start-ups. It was reported that several entrepreneurs managed to secure start-up funds for their projects.

I was also involved as an "Angel Investor" by investing in three projects which commercialized inventions of inventors. Unfortunately, all these ventures failed due to a number of reasons. The main reasons that these ventures failed were the following:

- The inventor did not focus on the development of the business as he was more interested in inventing rather than developing the business.
- The inventor was not very disciplined and I had serious problems of forcing him to record his business transactions.
- The inventor stopped and became uninterested in the business.
- I underestimated the cost of commercializing the invention.

Recently, the Malaysian Government established Cradle Sdn Bhd, which is a subsidiary of Ministry of Finance Inc. The company provides

seed funds for Malaysian entrepreneurs to refine their business ideas. This source of seed funds has reduced the need for money from "Angel Investors".

There are, however, informal networks of individuals who are willing to support new start-ups. These networks comprise wealthy individuals as well as owners of public listed companies.

Working with Angels

Unlike private equity managers whose funds are raised from other investors, "Angel Investors" invest their own money. They will request for a significant proportion of the equity of the start-up and take a more active part in the management of the start-ups. Many "Angel Investors" are seasoned investors themselves and entrepreneurs can take advantage of their business networks.

Other Unusual Sources of Capital

Are there such sources of capital? In my days as an active private equity manager, fortunately our investee companies did not have to look to such unusual sources of capital. However, I would like to highlight two possible sources of capital which I have tapped in the past. Unfortunately, due to the recent economic problems, these two sources are no longer active in investing in private companies.

State Economic Foundations

On the unusual sources of capital is the State Foundations in Malaysia, such as the Terengganu State Foundation and the Sarawak State Foundation. Terengganu State Foundation was a major private equity investor in the early 1990's when it had a major allocation from the oil revenue of the state of Terengganu. Sarawak State foundation was also a major private equity investor whose fund was allocated from the revenue of the state of Sarawak.

Cooperatives

Another unusual source of capital is the Cooperatives in Malaysia. Unfortunately, I do not have any experience of investing with a Cooperative in Malaysia. Based on our study, many Cooperatives in Malaysia have a significant amount of capital accumulated over the years from their profitable consumers lending activities. Several Cooperatives allocate a portion of their capital for private equity investments.

I believe entrepreneurs who are involved in consumer related products and services may want to consider the larger Malaysian Cooperatives to be investors in their companies. They can take advantage of the million members of the cooperatives who can become consumers. In addition, the Malaysian Government is also encouraging the Malaysian Cooperatives to be more active in new business ventures to diversify from their main activity of consumer lending. An entrepreneur, however, will have to evaluate carefully which cooperative is suitable to be invited as an investor.

Bumiputra Investment Institutions

When I was at PNB, I used to invest in companies that had the potential to be listed on Bursa Malaysia within three years. PNB is a large Bumiputra investment institution and was an active investor in private equity investment. A company in which PNB invested was Mesiniaga Sdn Bhd, which was the main distributor of computer mainframes and computer software. Unfortunately today, PNB has stopped its private equity investment activities and instead is concentrating on merger and acquisition of listed companies.

Another Bumiputra investment institution is the Pilgrim Fund Board or in Malay, it is known as Lembaga Tabung Haji. It was an active private equity investor like PNB. It has also stopped investing in private companies due its large portfolio of listed companies. Like any good investor, I am sure that these Bumiputra investment institutions will consider an investment that has a good potential.

The large Bumiputra investment institutions have several advantages to an investee company, and these include:

- They can invest a substantial amount of money due to their fund sizes.
- They can provide a network of government contacts and future government contracts.
- They tend to be passive private equity investors as long as the company performs.
- They can buy your firm if an opportunity arises.

I believe the large Bumiputra investment institutions are ideal private equity investors for private companies that meet their investment criteria. As they are managing a large portfolio of investment, they are not interested in interfering in the operation of companies. Their main involvement will be through their nominee on the Board of Directors.

These institutions are also managing a significant amount of funds and they are interested to invest a large amount of money if the investment proposal is viable and attractive. A company in which the large Bumiputra institution is an investor will be highly regarded by financial institutions which may be more willing to provide credit facilities to the company.

The most attractive companies to these Bumiputra institutions are private firms that have the potential to be listed on Bursa Malaysia within two or three years. My advice is that if your company has these characteristics, it is worth for the company to talk to these large Bumiputra investment institutions instead of discussing with the Malaysian private equity firms. They can be considered as passive investors which generally would not have the time to interfere in the operation of companies.

Keep "Marketing" Your Firm

As a private equity manager, I am always competing with other private equity firms for good investment candidates. The number of

good investment candidates is relatively modest in a small country like Malaysia which does not have a large number of medium-sized companies. Good investment candidates are well known to every private equity manager.

At the same time, I am also competing with other investors such as foreign private equity managers based in Singapore, wealthy angel investors, listed firms, Bumiputra investment institutions and other capital providers. They are all interested to invest in viable companies!

An entrepreneur who believes that he or she has a viable business can play “hard-to-get” while meeting several investors at the same time. Entrepreneurs should continue to “market” themselves in front of these potential investors.

Chapter 7

Post Investment Marriage

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Post Investment Marriage

After the Agreement is Signed

The entrepreneur has just realized that the process from the first meeting with the private equity manager to the signing of the shareholders' agreement has taken quite a while. The period can be as short as six months to as long as two years. My longest time was about two years when we invested in a Malaysian subsidiary of a Japanese company. The shortest was about six months from the first meeting with the entrepreneur to the signing of the shareholders' agreement.

When the process ends, the entrepreneur would have received the equity value of the company offered by the private equity manager. This equity value would typically be in the form of cash to the entrepreneur through the buying of the existing shares of the company and cash into the company through the issuance of new shares. Everyone expects that the marriage will be a fruitful one!

Once the shareholders' agreement is signed, there is an alignment of commercial objectives between the entrepreneur and the private equity manager.

Until this point, the relationship between the entrepreneur and the private equity manager is generally tense. The completion of the shareholders' agreement and the transfer of fund signify that the private equity manager and the entrepreneur have to begin from then onwards to trust each other more.

The Failure of Expected Working Relationship

As a private equity manager, I would like to develop our relationship with the entrepreneur according to the following understanding.

- The business targets to be achieved through mutual cooperation of managing the business.

- The control of costs in line with business objectives and targets.

- There is additional scrutiny and the consequences of closer scrutiny on management of the company.

- The need to add new skills into the company in order to achieve the business objectives.

- There is a synergy between the company and other investee companies of the private equity company.

- The actions required in case of failure of the private equity manager of exiting from the investment in the company.

Based on my experiences, I noted that many entrepreneurs had the strong believe that they could run the businesses as usual after the private equity capital has been injected into their companies. This is far from the truth!

The entrepreneurs need to realize that when they receive the capital from the private equity firms, they are sitting beside a nervous partner.

Anxious partners usually want to be updated on the progress of the business on a regular basis. I believe, in the excitement of the thought of receiving a significant amount of money from the private equity manager, the entrepreneurs may have not realized that the private equity manager would like to be at least "involved" in the decision-making of the investee company.

The private equity managers will be appointing their representatives on the Board of Directors of the companies and want to be consulted on key decisions. They would have included provisions in the shareholders' agreement that they are entitled to control specific financial activities.

In private equity investment, I would like to remind the entrepreneur that he or she is not only taking a financial investor but actually taking a "marriage partner". The "marriage" could be a rocky one! It is obvious that there is a need of significant changes in the running of the business. Unfortunately, more than 80% of the entrepreneurs did not heed this advice at the start of the relationship and waited longer to adjust to the new situation of managing the business.

Increased Cost of Managing the Company

The most significant change in the running of the company will be additional costs of compliance with the shareholders' agreement. The private equity manager expects more and frequent meetings of the Board of Directors and additional reports to be provided to them. In many instances, the private equity manager will be recommending that a reputable external auditor be appointed to replace the current auditor in line with the policy of the private equity company. This will mean high annual audit fees.

Additional Scrutiny in the Meetings of the Board of Directors

The major change in the marriage with a private equity company is the composition of the Board of Directors. I usually use the rule of thumb that I will want one representative for every ten percent of shareholding

in the company. The meetings of the Board of Directors will be more formal and frequent. The representatives of the private equity capital will be more critical of the management teams on matters of interest to the private equity company.

My advice to entrepreneurs is that they should ask a nominee who is experienced in a particular stage of the company. Generally, these new directors will be "passive" as long as the company is operating well. More scrutiny and longer meetings of the Board of Directors will happen when the operation of the company is not doing well. Life will not be a breeze for management!

The Necessity of Bringing in New Skills

At many younger companies as they grow, the external investors will normally recommend that the skill sets of the management team be enhanced and improved. The founder who started the company and secured the private equity capital may not be suited to run it as it grows.

The private equity manager will constantly advise the founding entrepreneur to make the necessary changes in the skill sets of the management team. Close friends of the entrepreneur who are not effective may be asked to go. In several cases, I had to ask personally the founder of our investee company to leave when we were very concerned about the progress of the company under his leadership.

Unless the company has been managed under a strict reporting structure, taking a private equity manager means that the company has a coach in the form of the external members of the Board of Directors who are pushing the management to perform better and better. Like it or not the entrepreneurs will have to work closely with them.

Increased Formality in the Operation of Companies

While private equity managers would like not to be involved in the

operations of the company, they want to know the status of the company as detailed as possible. The most important method used to monitor the company is the reports distributed to the Board of Directors. Of course, the private equity managers will insist for regular meetings of the Board of Directors.

Besides the increased frequency of the meetings of the Board of Directors, the private equity manager will also ask for additional meetings between the company and their senior staff to discuss other major issues affecting the company. Prior to our participation, it is not unusual for many of our investee companies to have only a single meeting of the Board of Directors in a year in order to approve the annual account!

Many entrepreneurs I found are quite receptive to the requirement of increased formality in the operation of the company after the participation of the private equity company. They usually understand from the beginning and during the pre-investment discussions that both parties want the business to be more profitable so that it can be sold in the future as a much significant value than what it is worth today.

Matters of Significant Interests to the Private Equity Manager

The entrepreneur should realize that the private equity manager is an experienced investor and it has a team of advisers such as accountants and lawyers to evaluate and invest in a company. The Shareholders' Agreement is the most important document that protects its interest in ensuring that its investment in the company will be profitable in the future. They also understand despite their skills in evaluating a company, there are still risks involved that their investment may not be profitable as envisaged.

The Shareholders' Agreement will have usual provisions that the private equity manager has the right to approve or reject key important decisions that the Board of Directors may undertake. I would insist in key decisions such as increased borrowings and key changes in senior

management need our approval through our representatives on the Board of Directors.

However, I usually act in a subtle manner to ensure that I do not have to undertake a drastic action against the company and its management team. I also accept the fact that the management team should be motivated to act according to my previous agreed financial and profit targets. One way of motivating the management team is by injecting my investment in successive amounts subject to the company achieving specific targets such as product development and sales growth. I will withhold the investment if the target is not achieved.

Further Funding Request by the Entrepreneur

At any time, the private equity capital will have a number of investee companies at various stages of growth and progress. In my case, we normally had a portfolio of about eight companies that require our management attention and capital. I will generally allocate a specific amount of capital for each investee company. I will increase my capital allocation to a company if I believe that money can further increase its profits.

Private equity capital managers are reluctant to provide an additional capital to a company if the capital call is unplanned as this reflects the failure of the management of the company. In a situation where there is a syndicate of investors, the capital call can be made by one of the syndication members who may decide to increase its investment in the company. Another alternative is that a new investor will be invited to inject new capital. One of the main requirements of the new investor is that the management team must be replaced with a new team appointed by the new investor. In addition, the company is expected to cut costs in order to release cash flows.

In the extreme case of poor performance, a private equity company will decide to withhold additional funding and let a company to survive on its own. In the jargon of the private equity industry, this company

is considered as a “zombie” or “a walking dead”. This company can operate for a number of years until it is closed when it runs out of money. The private equity manager had probably written off this investment.

A “zombie” may be lucky in that a new investor could be interested to inject new capital into the company. In this case, the current investors will have their shareholding diluted very significantly, resulting in a loss in the value of their investments. The company must have unique assets or an intellectual property (IP) which could turnaround the business with the new injection of capital. Unfortunately, my experiences showed that it is difficult to turn a “zombie” into a successful venture again due to various problems such as unmotivated management team and customer’s loss of confidence in the company. Eventually, the company would also be closed down with the IP sold to another party.

Post Investment Period

The post investment period in which the private equity manager is involved as an investor will vary depending on the stage of investment. In a start-up, the investment phase will be longer, ranging from five to seven years while in a more mature company, the investment phase will be shorter ranging from three to five years. During this period, the investor and the entrepreneur will have to work closely.

The skills of the private equity manager are to ensure that the company is well managed allowing the private equity manager to sell their shares within three to five years at a high profit. The entrepreneur, on the other hand, will have the necessary capital to expand the businesses of his or her company and also realize the reward both as an executive with higher salaries and an increased worth of his company.

As a professional investor, the private equity company has developed its own sets of investment disciplines which it imposes on its investee companies. It also provides value-added inputs to its investee companies so that they can grow significantly.

An entrepreneur will have a professional investor whose objective is to grow the company. He or she must develop the skills to develop an effective business relationship with the private equity manager. He has to realize that the private equity manager is also an owner of the company and has specific rights in the company according to the shareholders' agreement.

My experience showed that the failure of the entrepreneur to work closely with the private equity manager was mainly due to the personalities of the entrepreneurs. The majority of the entrepreneurs were reluctant to provide detailed information of the company to the private equity managers or its representative on the Board of Directors.

The privately equity manager will "punish" these companies by withholding capital as well as reject management proposals during the meetings of the Board of Directors. Ultimately, the private equity managers will lose interest in these companies and focus their efforts on other investee companies that they believe will have a greater potential.

As a private equity manager is not involved in the day-to-day operations of the company, he or she does not like an element of surprise with regards to issues and events that may affect the profit and long-term viability of its investee company. It is the duty of the entrepreneur to inform the private equity manager if such events occur.

Just like marriage, living with a private equity manager will also require a good understanding by the entrepreneur as far as the main objective of the investment partnership is concerned.

Sharing of Rewards through Exits

CHAPTER 8

Sharing of Rewards through Exits

The Good Outcome of Investment

Before the use of computers to match the purchases and sales of shares on the stock market, this process was done manually by brokers though hand signals and shouts on the trading floors. The trading floor was bustling with activities. When a company was to be listed on the Kuala Lumpur Stock Exchange (KLSE), now known as Bursa Malaysia, the Board of Directors and other guests would be invited to stand on a public gallery of the KLSE which faced the trading floor to mark the first trading of the shares of the company. The chairman of the company will hit the “gong” with a bang, and that indicated the signals to the brokers on the trading floor that the shares could start trading. The shouting on the trading floor would begin!

The first traded price of the share would be posted on a TV screen in the room in which the Board of Directors were seating. There would be huge smiles on the faces of the members of the Board of Directors if the first traded price of the share was higher than the initial public offering (IPO) price. Everyone would be silently counting the increase their shares in the company.

I was fortunate to share these joys on many occasions which were the result of my successful investment in private companies which were listed on Bursa Malaysia. The shares which I held in these companies were now liquid and could be sold to other investors.

Planning the Exit of a Private Equity Investment

It is important that a private equity manager is able to sell the shares he or she holds in private companies at an opportune time. The typical method of exit is to sell these shares on the stock market.

At the beginning of the discussions between the private equity manager and the entrepreneur, it would be emphasized that the private equity firm would have to realize its investment and there would be an agreement by the entrepreneur that he or she would work towards this investment disposal in the right time in the future. This understanding and commitment by the management of the company will be further reinforced in the shareholders' agreement.

During subsequent investment phase, the management and the private equity manager will always be in continuous discussion with the steps and action plans for listing of the company on the stock market. A share underwriter would be identified and approached to evaluate the potential on the listing exercise. Based on my experience, the idea of listing the company will excite the management team and the shareholders.

The planning of the listing exercise will be tasked to a group of managers who will work closely with a financial advisor. The listing exercise is complex and has to be executed well. Many decisions will be required from the Board of Directors as well as the shareholders of the company.

The timing of the listing exercise will be decided by the financial advisor. A listing exercise can be postponed to a more suitable date if it is believed that the investment climate will not yield the maximum benefit to the company. The Board of Directors will have to consider the costs of the listing exercise which typically can cost more than RM1.0

million. There will be also costs of complying with the continuing listing of the shares.

Other Options of Exits for the Private Equity Firm

The listing of the shares of the company and subsequently selling them on the stock market is the most preferred method of investment disposal. In many instances, the private equity manager and the management team are willing to wait for several years until an opportune time is presented to list the shares on the stock market.

The private equity manager will also consider other options to dispose its investment in a company through the following:

- Trade sale.
- Shares repurchase by founders and other shareholders.
- Write off the investment.

Trade sale is a second best option for the private equity manager as it will involve less regulatory requirements when compared to listing the shares on the stock market. The trade sale can be initiated by the private equity manager where the parties agree to purchase the company by an industrial company. The worth of the company could be higher than in the case of a listing on a stock market if the company is deemed to provide valuable synergies to the buyer.

In other instances, the trade sale can be driven by the desire of the management team not to be involved in running a listed public company which is governed by strict regulatory rules and procedure.

The decision to sell the company to another firm can be influenced by both the private equity manager and the management team who both believe the trade sales will be beneficial to the company. This could be driven by the fact that the investors are not able to inject a substantial amount of money to implement new expansion plans or the business is languishing due to weak business prospects.

In other instances, an investor just loses patience with the management team, and it believes that the business is better off under someone else's management. The management team may not be able to resist the pressure placed on the investor as the private equity manager may use the provisions in the shareholders' agreement by refusing to approve management proposals on key corporate decisions.

Trade sales forced by the private equity manager may not go down well with the management team. The members of management team could be required to swap their existing shareholding into shares of a new company. They may also lose their posts in the new company.

The Malaysian private equity manager typically includes a provision in the shareholders' agreement that states that the founding shareholders will be required to purchase the shares held by the private equity manager if the company is not listed within a specific period of time. A nominal interest rate on the investment is also calculated. It is usual that the founding shareholder will not have the capacity to raise the capital required to make such shares re-purchases. Knowing share re-purchasing is not practical, the private equity manager will put pressure on the management team to consider share listing or trade sales when the time is right.

The private equity manager knows that a viable business will eventually be able to meet the listing requirements of Bursa Malaysia. In one case I agreed not to pursue the share re-purchase provision and waited more than eight years before the company was floated on the main section of Bursa Malaysia. By agreeing to postpone the listing exercise, I managed to list the shares and realized significant capital gains. The postponement of the listing exercise was also due to unfavorable stock market conditions during the period.

The Case of a Corporate Failure

Despite the detailed evaluation of the companies, there is a possibility that a few companies in the portfolio of the private equity manager will not be performing. They are in such a dismal state that they are

not attractive to any trade buyer even at a nominal price. I call these investee companies “zombie”.

While a private equity manager tries to salvage the company, the normal and appropriate decision is to close the business. This is also to avoid the private equity manager to spend valuable management times on these “zombie”. The private equity manager should focus his or her efforts on the companies that could offer high potential returns on investment.

The private equity manager will recommend to its Board of Directors to write off the “zombie” as failed investments. Even so, a private equity manager is usually very careful and will try to avoid investment failures as these events can lead to a number of implications to the private equity company, the private equity managers and the shareholders of the company concerned. These implications include the following:

- These failed investee companies will reduce the portfolio rate of return of the private equity fund.
- The lower rate of investment return will also affect the “carried interest” of the private equity company.
- It affects the reputation of the private equity manager although it is understood in the private equity industry that there would be bad apples in a private equity company’s portfolio.
- It takes the time of the private equity managers away from doing profitable deals.
- It may affect future capital raising exercises for new funds due to the perception that the private equity manager is involved in too many poor deals.

The decision by private equity managers to force closures of their failing companies will have long-term impact on their reputation among potential entrepreneurs. Entrepreneurs will tend to decide to invite only

those private equity companies which are more sympathetic with the entrepreneurs and management team.

Conclusion

The success of the private equity managers is based on very important and clear criteria which are stated in the management agreement between the private equity manager and the investors (limited partners) in the private equity funds. The private equity manager will want to invest in a selected portfolio of companies which are carefully evaluated.

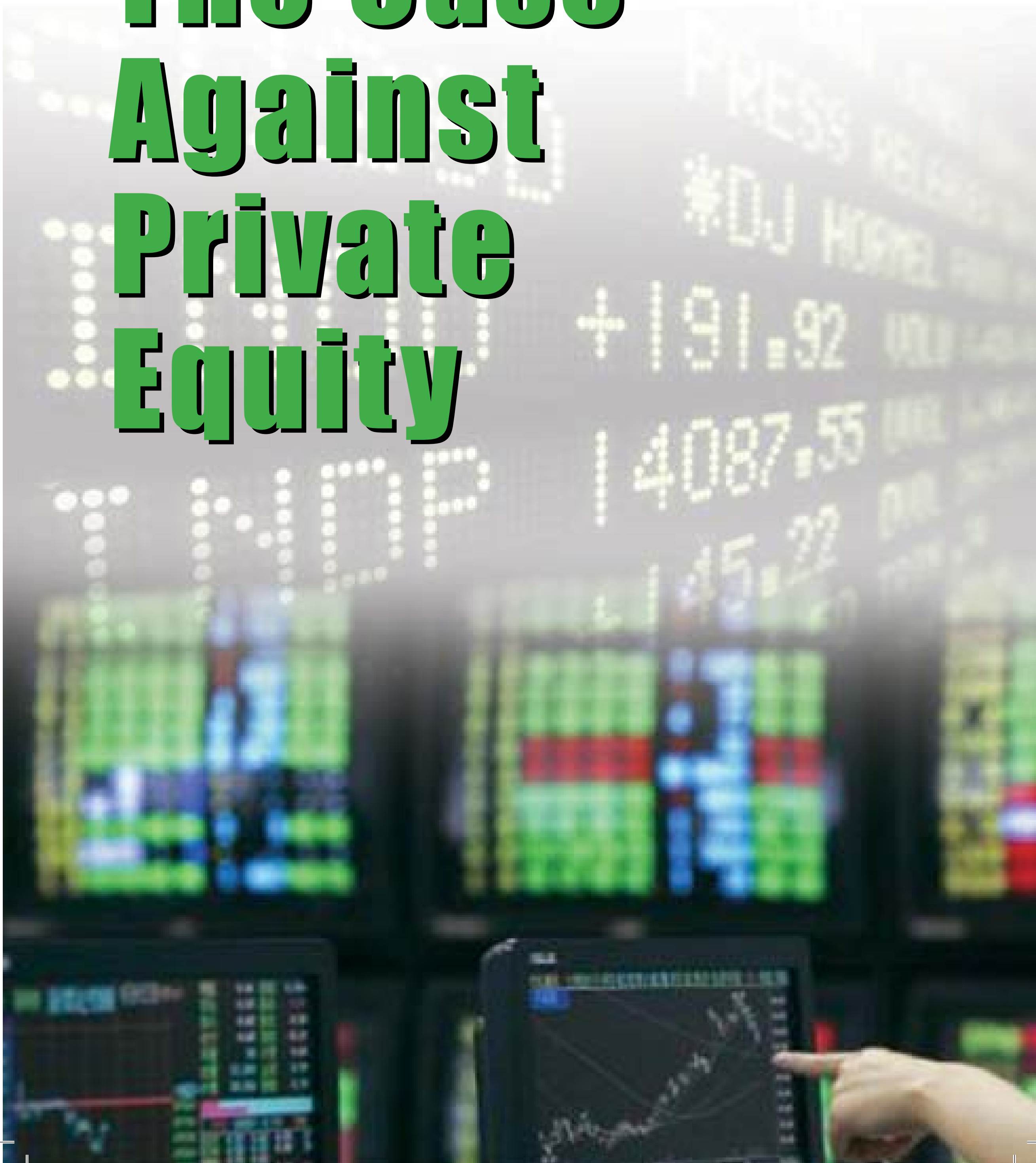
The companies should be able to be divested at a significant overall capital gain. Depending on the limited partnership agreements, the private equity manager will be rewarded a part of the capital gain through profit sharing called “carried interest”. The “carried interest” will be the main incentive for the private manager in managing the private equity funds.

The track record of the private equity managers will be based on the number of companies exited and the capital gain realized. The private manager will attempt to reduce the chance of failure in its investee companies by skillfully guiding and “pressuring” the management teams of these companies to ensure that the business targets are achieved within the period agreed or earlier.

The private equity managers will use their vast experience of corporate management. There is a significant need of the private equity manager to divest its investment as soon as practicable and at a profitable value.

Chapter 9

The Case Against Private Equity



CHAPTER 9

The Case Against Private Equity

Do You Still Want Private Equity?

The concept of private equity is that a group of individuals gather funds from a number of institutional investors and then invest the capital in a portfolio of companies. The shares of these companies are divested in the future for a huge capital gain. The capital and the capital gain are returned to the institutional investors with a portion of the capital gain is shared by the group of individuals.

The process is repeated with the group of individuals will raise another round of bigger amount capital from the same institutional investors and new investors.

To the entrepreneur, he/she will secure the fund necessary to expand his/her company and increase the worth of his/her company over time. In securing the fund, he/she needs to sell an equity stake of the company to the private equity manager. He/she will then need to work together with the private equity manager until such time the private equity manager divests the shares of the company.

In many instances, the partnership between the entrepreneur and the private equity manager can be considered as a “marriage of convenience”, where one is using the other to achieve his/her financial and business objectives. Of course, a “marriage of convenience” can have its own problems.

My advice to entrepreneurs is that despite what I recommended in the previous chapters, there are disadvantages of private equity as a source of funding for a business.

Other Sources of Capital Reconsidered

In the US, the private equity industry mainly specializes in finding and funding young companies with the potential and business models to grow significantly in the short-term. In this regard, the private equity industry plays a role in creating new industries and services.

In Malaysia, the private equity managers invests mainly in the expansion phase of companies and avoid investing in new start-ups due to the perceived high risks of failure. This means that these companies are already operating profitably. The companies with the track records can secure funding from traditional sources such bank loans from commercial banks or government-backed development banks such as Bank Pembangunan Malaysia and Perbadanan Usahawan Nasional Bhd (PUNB).

PUNB can provide soft loan facilities with minimum collateral requirements. This means that the entrepreneur can expand his/her company without giving away a portion of the equity of the company to PUNB. There is also a possibility that the loan of PUNB can be converted at a later date into equity when the company is worth more, thus reducing the proportion of the equity to be given away to PUNB.

Another source of capital is the “grant scheme” that are available from several Malaysian Government organizations, especially for capital to be used for R&D expenditure. The main advantage of the “grant

scheme" is that it is free money from the Malaysian Government. Thus, the entrepreneur should consider this favorable form of sourcing capital.

Basically, the types of companies that are attractive to Malaysian private equity companies are those that have established track records. These companies are also attractive to commercial banks which provide corporate loan facilities. Thus, they will likely search for private equity managers who can provide the capital as well as corporate value-added services that can guide the companies to navigate the business environment.

On the other hand start–up companies have lesser number of funding options. These are likely not to be attractive to commercial banks unless they can provide the required collaterals. In addition, they are also less attractive to private equity managers. The possible option of capital will be the "angel investors". For Bumiputra companies, sources of capital such as PUNB should be considered.

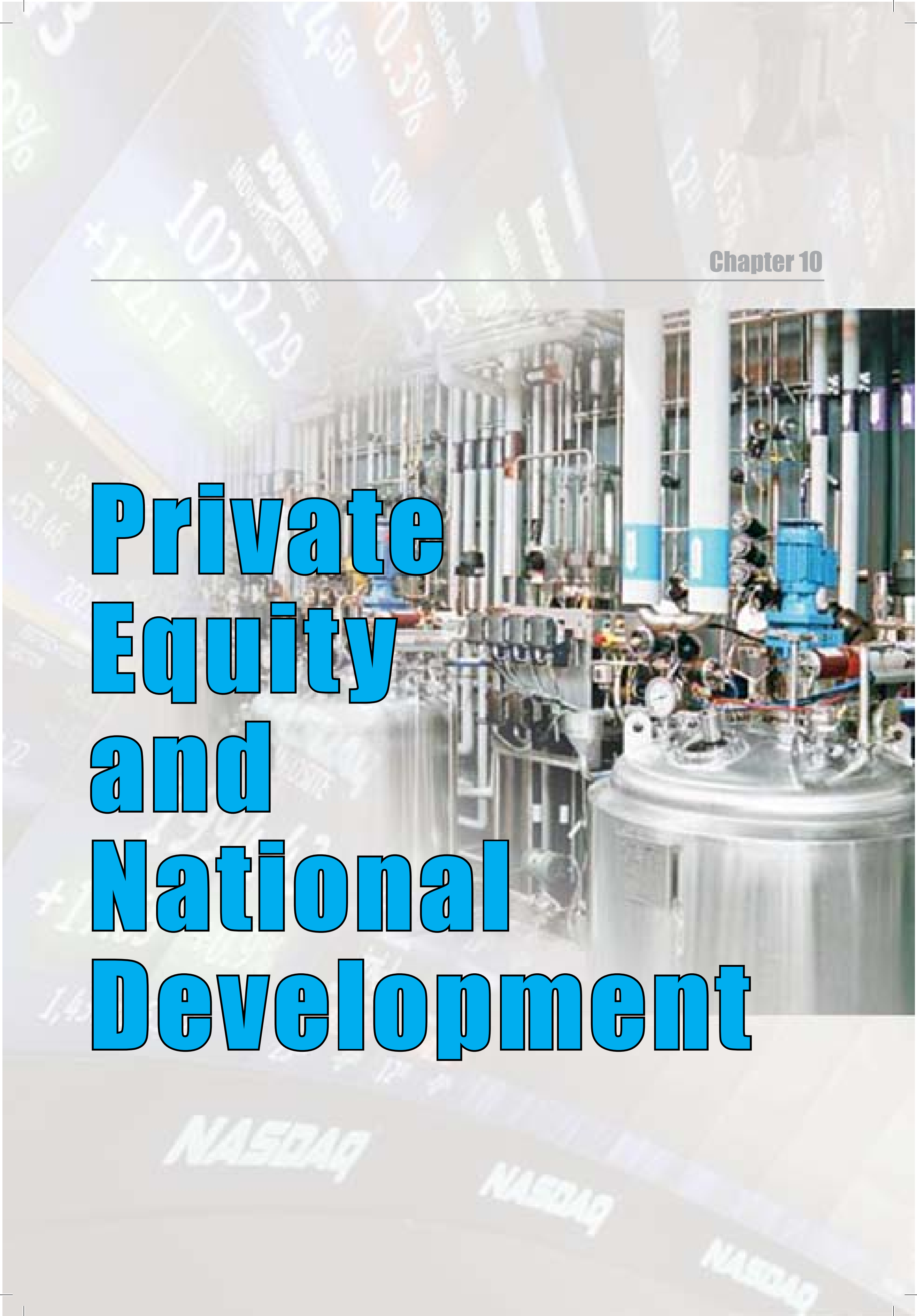
Overall Verdict of Private Equity as a Source of Fund

The book is written with the purpose of highlighting the operation of a private equity firm and the technique to secure such funds. Since I entered the private equity industry in the early 1990's, it has matured and today many private equity funds are established by the Malaysian Government and private organizations.

The Malaysian Government-backed private equity companies are established to spearhead the growth of specific industries which will not be funded by privately-owned private equity firms. In this regard, the Malaysian Government-owned private equity companies are important economic institutions.

Malaysian commercial banks have also established their own private equity firms by focusing on their existing clients which require funding which is an alternative to bank loans. Compared to the initial years,

private equity capital has become very familiar with entrepreneurs. The listing of many successful private equity-backed companies has further reinforced the advantages of private equity capital as a source of fund. I believe the private equity industry will become more developed in the future with the entry of more private equity firms.



Private Equity and National Development

CHAPTER 10

Private Equity and National Development

Funding Innovations

The role of private equity funds in nurturing high technology companies, especially in Silicon Valley, USA, is well-known. Many private equity companies are willing to provide start-up capital to entrepreneurs and their management team who are developing new products and services. A good idea started by well-known serial entrepreneurs will attract a number of private equity funds.

The private equity managers expect a few of the successful investments will provide significant capital gains to compensate for a number of investment losses. The most successful investments are defined as "home runs". Generally, investing in new start-up involves high risk. The private equity manager and the founders must develop the appropriate business strategy in order to sustain the company amidst keen competition from other companies. A company will be closed when the private equity firm stops funding it unless a new investor is secured.

The success of Silicon Valley in nurturing high technology firms is influenced by a number of factors which are closely interconnected. These factors include the following:-

- Presence of a large number of private equity funds which are willing to invest in new start-up. These private equity funds are also managed by very seasoned managers who understand the needs of new high technology start-ups.

- Availability of business and technical managers who are willing to work in start-ups backed by private equity firms. These business and technical managers are attracted by start-ups as they are usually given share options at minimal prices. These share options can become very valuable if their companies are purchased by another company or the shares are listed on NASDAQ, the high technology stock exchange. If the current company fails, the business and technical managers will move on to another start-up. A very experienced technical manager often moves many times before he “makes” big with a successful company.

- Presence of large companies. These companies acquire young and promising companies. Thus, there is a vibrant merger and acquisition activity. Younger companies get acquired by bigger companies and thereby providing the management team and their private equity managers with financial gains. The private equity managers and the management team can form another venture.

- Presence of technology-source organizations. The major and medium-sized companies in Silicon Valley provide the seeds of innovations. Many engineers left these companies to establish new start-up backed by private equity firms. Companies such as Intel and Stanford University are key technology-source organizations.

Creating Malaysian Technology Clusters

The Malaysian Government had recognized that private equity funds can help in the nurturing of high technology companies as in Silicon Valley. MAVCAP and MTDC were established to provide private equity funds to support the development of high technology companies.

The success of these organizations in nurturing high technology companies has been mixed. Data showed that only a small number of start-up received private equity funds from government-backed private equity organizations. Private equity funds are reluctant to invest in new start-up due to the high risk involved. In addition, the Malaysian private equity managers have limited experiences in nurturing start-ups.

It is hoped that the Malaysian Government will continue to support the funding of more private equity funds that specialize in technology-based start-up. Dan Senor and Saul Singer in their book,"Start-up Nation; The Story of Israel's Economic Miracle", quoted that private equity funds that are established by the Israeli Government had contributed to the creation of numerous technology companies.

The Malaysian New Economic Model also envisages an innovative society based on exploitation of new technologies. The provision of private equity capital is a key ingredient of this Malaysian Economic Model.

Final Conclusion

This book is written with the objective of helping entrepreneurs to understand private equity and to improve their chances of securing private equity funds. I hope I have been successful in this aspect.

Private equity firms are specifically financial investors, and private equity investing is not about taking risks; it is about reducing risk by investing only in selected growing companies.

Private equity is about selling a portian of your company to a financial

investor, namely a private equity company. This means you will have less freedom in managing your firm as your management style and decisions will be “checked” by your private equity manager.

There are several advantages of having a private equity firm as an investor in your company. However, an entrepreneur may forgo a private equity investment and work independently or through bank loans to expand his or her business towards initial public offering (IPO). A good and profitable company will always get “what it wants”.

At the time of writing this book, the Malaysian Government had announced the establishment of a private equity company called Ekuiti Nasional Bhd (National Equity Corporation). Ekuiti Nasional Bhd aims to be a major provider of private equity to Malaysian private companies and had been provided with an initial allocation of RM500 million. It was reported that it had invested in three companies.

I believe the establishment of Ekuiti Nasional Bhd will significantly increase the amount of private equity capital available to companies with good potential through mezzanine-stage financing.

However, from a national development point, more private equity capital should be made available to early-stage companies and start-ups as private equity for established firms are well served by many existing private equity funds.

BUSINESS VALUATION REPORT

ABC TECHNOLOGY SDN BHD

As of 22nd, February 2008

For Datin Azimah Rashid, Chairman

By
Bison Consulting

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SECTION 1

Valuation Summary

DESCRIPTION OF THE VALUATION ASSIGNMENT

Bison Consulting has been retained to determine the fair market value of ABC Technology Sdn Bhd, hereinafter referred to as ABC Technology, as at February 22nd, 2008. The purpose of the valuation is to establish a value for selling part of the shares of the firm by the owners to a new investor.

FINDINGS

The fair market value of ABC Technology is RM16,380,000 as of February 22nd, 2008 and is shown in Table 1-1, based on weighting of income and market-based valuation methods.

For ownership control (50% plus 1 share) the fair market value of ownership equity is RM15,910, 000 and the minority ownership equity is RM12,728,000.

Table 1-1: Fair Market Value of ABC Technology as of February 22nd, 2008

Total Fair Market Value	Value (RM)	Weight	Weighted Value (RM)
Income Valuation Method Discounted Cash Flow	17,500,000	60%	10,500,000
Market Valuation Method Public Company Revenue Multiple	20,900,000	20%	4,180,000
Market Valuation Method Public Company EBITDA Multiple	8,500,000	20%	1,700,000
Total Fair Market Value Based on Weighting Income and Market Valuation Method			16,380,000
Minus			
Total Debt (Shareholders' advance)			470,000
Other Liabilities			–
Equals			
Fair Market Value of Ownership Equity with Control (Ownership of 50.1% or more of Company Stock)			15,910,000
Minus			
Control Premium (20.0%)			3,182,000
Equals			
Fair Market Value of Minority of Ownership Equity (Ownership of 49.9% or Less of Company Stock)			12,728,000

Summary Description of the Company

ABC Technology is a privately held company operating primarily in the design, development and integration of electronic systems. The Company is registered with the Ministry of Finance as a Bumiputra Company. Traffic control system is the best selling product of the Company and

contributes a significant portion of its revenue. The Company also provides a variety of SCADA applications, ICT solutions, and solutions for security and defense industries. The main customers of the Company are Government departments and public sector organizations.

The Company has completed numerous ICT projects since its incorporation 19 years ago. The Company is registered with various Government bodies and Government-owned companies for the purpose of participating in project tenders.

Review of Company Financials

We have reviewed the audited annual reports of the Company for 2004, 2005, 2006 and 2007.We have also reviewed the balance sheets of the Company as at December 31st, 2007.

Company Financial Performance

The Company's revenue had increased from RM8,256,955 in 2004 to RM10,687,946 during the 12 months ending on September 39th, 2007. The revenue value for the most recent 12 months ending September 30th, 2007 is the most reasonable starting point for the valuation analysis since it is the most current and if falls within the range of revenue performance for ABC Technology. Profit before taxation for ABC Technology has increased from RM191,464 in 2004 to RM1,086,102 in 2007. For valuation purposes, we have adjusted the earnings of the business for use in the EBITDA valuation calculations and the discounted cash flow valuation after making other adjustments to the financials for valuation purposes. Table 1-2 shows a summary of income of ABC Technology.

Table 1-2: Summary Income of ABC Technology (in RM)

Year Ending September 30th	2007	2006	2005	2004
-Contracts fee received	10,687,946	6,993,592	7,161,386	8,256,955
-Less cost of contract				
Inventory (Opening)	531,667	401,476	537,444	408,798
Purchases	7,260,711	4,850,324	5,383,006	6,473,512
Freight and import duties	14,293	25,157	14,999	25,681
Transportation	8,623	2,398	5,609	4,010
Less closing inventory	435,424	531,667	401,476	537,444
Cost of Contract	7,379,870	4,747,688	5,539,582	6,378,971
-Less direct expenses				
Bonus	89,770	40,140	33,255	59,323
Insurance	63,798	5,791	1,485	5,862
Exhibitions	55,415	63,656	16,136	28,925
Salaries and wages	606,940	508,713	395,600	454,744
Tender fee	3,200	580	383	341
Motor vehicle upkeeps	76,491	57,431	39,275	44,566
Total	895,614	676,311	486,134	593,761
Total Contract Cost	8,275,484	5,423,999	6,025,716	6,972,732
Profit on Contract	2,412,462	1,569,593	1,135,670	1,284,223
-Other operating income				
Discount received	387	2,623	4,587	4,798
Income from investment	705	731	2,532	2,485
Total	1,092	3,354	7,119	7,283
Less administration cost	1,298,189	872,556	971,830	1,068,200
Profit from operations	1,115,365	700,391	170,959	223,306
Less finance charges	29,263	19,975	25,268	30,042
Profit Before Tax	1,086,102	681,416	143,621	191,464
Income tax	64,310	81,000	-	-
Net Profit for the Year	1,02,793	600,416	143,621	191,464

Owner Compensation Review

We have reviewed the owner compensation, which included bonus, director's fee and director's salaries. We have made certain adjustments for the computation of Free Cash Flow to the Firm.

Adjustments to the Income Statement

Table 1-3: Income Statement for the Year Ending September 30th, 2007 Adjusted

	Unadjusted (RM)	Amount Adjusted (RM)	Adjusted (RM)
-Revenue			
Contract received	10,687,946	0	10,687,946
-Less Cost of contract			
Inventory (Opening)	531,667	0	531,667
Purchases	7,260,711	0	7,260,711
Freight and import duties	14,293	0	14,293
Transportation charges	8,623	0	8,623
Less closing inventory	435,424	0	435,424
Cost of Contract	7,379,870	0	7,379,870
-Less Direct expenses			
Bonus	89,770	-89,770	0
Insurance	63,798	0	63,798
Exhibitions	55,415	-20,000	35,415
Salaries and wages	606,940	0	606,940
Tender fee	3,200	0	3,200
Upkeep of motor vehicles	76,491	-35,000	41,491
Total	895,614	-144,770	750,844
Total Contract Cost	8,275,484		8,130,714
Profit on Contract	2,412,462		2,557,232
-Other operating income			
Discount received	387	0	387
Income from investment	705	0	705
Total	1,092	0	1,092
-Less administration expenses			
Advertisement	1,155	-1,155	0
Allowance for doubtful debts	230,000	-230,000	0
Amortization of R&D cost	70,808	0	70,808
Audit fee	7,000	0	7,000
Bonus	21,780	-21,780	0
Certification fee	15,973	0	15,973

	Unadjusted (RM)	Amount Adjusted (RM)	Adjusted (RM)
Certification fee	15,973	0	15,973
Depreciation	142,312	0	142,312
Directors' remuneration			
Bonus	49,400	-49,400	0
Fee	130,000	-65,000	65,000
Salaries	191,400	0	191,400
EPF contribution	70,767	0	70,767
Gifts and donation	700	-700	0
Insurance	4,915	0	4,915
Legal fee	13,101	-7,00	6,101
License fee	25,152	0	25,152
Medical fee	11,167	-5,000	6,167
Newspapers	1,672	-500	1,172
Postages and stationary	59,199	-10,000	49,199
Rental of premise	6,396	0	6,396
Salaries	118,890	0	118,890
Secretarial and accounting fee	6,389	0	6,389
Socso	10,916	0	10,916
Telephone charges	27,839	-7,000	20,839
Training	20,915	-10,000	10,915
Travel expenses	8,432	0	8,432
Water and electricity charges	51,911	-5,000	46,911
Total	1,298,189	-412,035	883,154
Profit from operations	1,115,365		1,674,078
Less Finance charges	29,263	0	29,263
Profit before taxation	1,086,102		1,644,815
Income tax expenses	64,310		82,240
Net Profit for the year	1,021,793		1,562,575

VALUATION RESULTS: DISCOUNTED CASH FLOW METHOD

Using the discounted cash flow method, the total fair market value for ABC Technology is RM17,500,000. The ownership composition of that estimate is shown in Table 1-4. The valuation results reported are as of

February 22nd, 2008. The discounted cash method uses our financial projection of ABC Technology for the next five years, based on likely performance of the Company. We have assumed that the revenue of the Company will increase by RM2.0 million every year for the next 5 years from 2008. We have assumed that the Company will enjoy a Terminal Growth Rate of 4%, reflecting a moderate growth rate in the terminal phase.

Table 1-4: Component of Value Using Discounted Cash Flow Method (in RM)

	Equity Component	Value
Ownership Equity		
-Minority Value	14,172,310	
-Additional Value due to Control	+ 2,834,462	
-Total Ownership Equity		17,006,772
Preferred Equity		-
Total Debt (Book value)		470,000
Other liabilities		-
Estimated Fair Market Value		17,476,772
Rounded off		17,500,000

A summary of the intermediate values used to determine the discounted free cash flow valuation shown in Table 1-5.

Table 1-5: Valuation Calculation Summary for Discounted Free Cash Flow Method

Equity Component	Value
After Tax Weighted Average Cost of Capital	13%
Present Value of Free Cash Flow to Firm (FCFF) after factoring in Net Capital Expenditure and Change in Working Capital for years 2008 to 2012	
Year 2008	RM853,547
Year 2009	RM974,635
Year 2010	RM1,062,515
Year 2011	RM1,105,574
Year 2012	RM1,130,107
Terminal Value	RM13,059,009
Sum of Present Value of FCFF plus Terminal Value	RM18,185,387
Excess Cash	-
Sum on Non-Operating sources of value	-
After Tax Total Value	RM18,185,387
Total Debt (Shareholders' advance)	RM470,000
Minority ownership value before control premium and liquidity discount	RM17,715,387
Loss of ownership value due to liquidity discount of 20%	RM3,543,077
Minority ownership value	RM14,172,310
Gain in ownership value due to control premium of 20%	RM2,834,462
Total ownership equity	RM17,006,772
Total debt	RM470,000
Total fair market value	RM17,476,772
Rounded off	RM17,500,000

VALUATION RESULTS: MARKET MULTIPLE METHOD

Table 1-6 provides a brief description of the public firms which are involved in the ICT industry and listed on MESDAQ market of Bursa Malaysia. MESDAQ market allows young ICT companies to list their shares and raise capital. The MESDAQ market provides an indication of the market value of ICT companies like ABC Technology.

Table 1-6: Details of Peer Group

Firms	Sales (RM)	Profit from Operation (RM)	EBITDA (RM)	Shares Outstanding	Price per Shares (RM)	Market Value (RM)
Firm 1	17,922,037	1,722,974	2,035,900	105,646,000	0.070	7,395,220
Firm 2	15,630,781	1,738,691	2,851,903	104,400,000	0.15	15,660,000
Firm 3	15,887,018	5,343,883	5,647,233	98,511,060	0.76	74,868,405
Firm 4	46,735,713	7,542,531	9,190,392	124,182,533	0.42	52,156,663
Firm 5	10,572,799	4,221,712	6,192,636	121,216,000	0.47	56,971,520
Firm 6	57,840,393	10,233,675	11,279,888	212,798,000	0.26	55,327,480
Firm 7	38,107,050	10,859,767	12,848,129	200,000,000	0.21	42,000,000
Firm 8	39,445,000	8,881,000	9,422,000	248,000,000	0.195	48,360,000

Table 1-7 shows financial comparison of peer group with ABC Technology.

Table 1-7: Peer Group Financial Comparison

Company	Sales (RM)	EBITDA (RM)	Price per Shares (RM)	Market Value (RM)	Market Value devived by Sales (RM)	Market Value devived by EBITDA (RM)
ABC Technology	10,686,946	1,328,946	-	-	-	-
Firm 1	17,922,037	2,035,900	0.07	7,395,220	0.41	3.63
Firm 2	15,630,781	2,851,903	0.15	15,660,000	1.00	5.49
Firm 3	15,887,018	5,647,233	0.76	74,868,405	4.71	13.26
Firm 4	46,735,713	9,190,392	0.42	52,156,663	1.12	5.68
Firm 5	10,572,799	6,192,636	0.47	56,971,520	5.39	9.20
Firm 6	57,840,393	11,279,888	0.26	55,327,480	0.96	4.90
Firm 7	38,107,050	12,848,129	0.21	42,000,000	1.10	3.27
Firm 8	39,445,000	9,422,000	0.195	48,360,000	1.23	5.13
Average for MESDAQ software firms					1.99	6.32

As can be seen from Table 1-7, ABC Technology operates on an equal scale with several of the MESDAQ-listed companies. After a careful

review of product mix and financial characteristic differences between ABC Technology and the peer group firms, we concluded that both revenue and earning-based market multiples are appropriate to develop a market method fair market value.

Valuation Using Revenue Market Multiples

We have generated a public company revenue multiple valuation method for ABC Technology. The steps in the process and the final results are shown in Table 1-8.

Table 1-8: Valuation by Public Company Comparable Method-Revenue Multiple

Market Method Valuation Findings based on Revenue Multiple for Public Company Comparables	
1. Revenue for valuation purposes Multiply by:	RM10,687,946
2. Average of public company market value to revenue basis Equals	1.99
3. Fair market value of ownership equity-public company basis Minus	RM21,269,012
4. Liquidity discount for privately-held firm (line 3 multiplied by liquidity discount factor of 20%) Equals	RM4,253,802
5. Fair market value of ownership equity-private company basis Plus	RM17,015,210
6. Control premium (line 6 multiplied by control premium percentage by 20.0%) Equals	3,403,042
7. Fair market value of ownership equity Plus	RM20,418,252
8. Debt (shareholders' advance) Equals	RM470,000
9. Total fair market value-market method of valuation – revenue multiple Rounded off	RM20,888,252 RM20,900,000

Valuation Using EBITDA Market Multiples

In addition, we have also generated a public company EBITDA multiple valuation result for ABC Technology. The steps in the process and the final results are shown in Table 1-9.

Table 1-9: Valuation of Public Company Comparable Method-EBITDA Multiple

Market Method Valuation Findings based on EBITDA Multiples for Public Company Comparables	
1. Revenue for valuation purposes Multiply by:	RM1,328,485
2. Average of public company market value to EBITDA ratio Equals	6.32
3. Fair market value of ownership equity-public company basis Minus	RM8,396,025
4. Liquidity discount for privately-held firm (line 3 multiplied by liquidity discount factor of 20%) Equals	RM1,679,205
5. Fair market value of ownership equity-private company basis Plus	RM6,716,820
6. Control premium (line 6 multiplied by control premium percentage by 20.0%) Equals	RM1,343,364
7. Fair market value of ownership equity Plus	RM8,060,184
8. Debt (shareholders' advance) Equals	RM470,000
9. Total fair market value-market method of valuation – revenue multiple Rounded off	RM8,530,184 RM8,500,000

Weighting the Valuation Method

To determine a final value for the equity ownership interest of ABC Technology, we have carefully considered the degree to which the facts of this assignment are consistent with the key assumptions of the methods

of valuation used in this assignment, public company market multiples and discounted cash flows. It is our judgment that the public companies available for use as comparables are of limited use as comparables due to the significant differences in size compared to ABC Technology. Accordingly, we have assigned the weights as shown in Table 1-10 to the valuation results generated by the different methods employed in this assignment. These have been applied to produce the results shown in Table 1-10.

Table 1-10: Weighting of Different Valuation Results

Valuation Method	**Weight**
Discounted Cash Flow Method	60%
Public Company Comparable-Market value to revenue multiple	20%
Public Company Comparable-Market value to EBITDA multiple	20%
Sum of the valuation weight	100%

VALUATION ASSIGNMENT TERMS AND CONDITIONS

Bison Consulting is independent of ABC Technology and related organizations, and neither have we had any financial interest in the securities subject to appraisal. Our fee for this valuation is in no way influenced by the result of our valuation conclusion. This valuation report is prepared solely for the purpose stated herein.

The remaining sections and appendices further describe the analyses performed and the conclusions reached during valuation. The attached certification, limitations of liabilities, statements of contingent and limited conditions, and our qualifications are integral part of this valuation opinion.

Dato' Anuar Md. Nor February 25th, 2008

SECTION 2

The Valuation Assignment

DESCRIPTION OF THE ENTITY BEING VALUED

ABC Technology is a privately held company operating primarily in the traffic management systems and ICT solutions for the security and defense industries. The Company is also a registered Bumiputra Company with the Ministry of Finance, Malaysia.

The Company was incorporated by the present Chairman, Datin Azimah Rashid, 19 years ago. The corporate address of the Company is Wisma ABC, Lot 100, Jalan Medan, 68000, Ampang, Selangor, Malaysia.

The valuation results are based on information from the Company's financial results for the 12 months ending September 30th, 2007, a review of the Company's four years of income statements and four years of its balance sheets and valuation interviews with the Chairman and senior staff of the Company.

The valuation is for the income generated by the total entity from the main business operations, from the income generated by other non-operating activities, such as investments in real estate or in other companies, and

for the value of assets on the balance sheet in excess of those needed for working capital.

Valuation Key Assumptions

A key assumption of this valuation is that the assets of ABC Technology, such as production equipments, technology, patents, intangible assets, or real estate holdings, have no greater value as standalone assets than they have as profit-generating assets for this business. Based on the information provided on this entity, we have determined that no adjustment to the valuation is necessary for assets with greater market value than their current income stream.

REVENUE AND PROFIT

Revenue for ABC Technology in the 12 months ending September 30th, 2007 is RM10,687, 946 as can be seen from Table 2-1. Before tax operating earnings defined as net receipts less all expenses excluding taxes paid is RM1, 086, 102. The before tax operating profit margin is 2.7%. The before tax operating profit margin indicates on average how much profit the firm generates per RM1 of revenue.

Table 2-1: Summary Income Statement for ABC Technology

Year Ending September 30th	2007	2006	2005	2004
-Contracts fee received	10,687,946	6,993,592	7,161,386	8,256,955
-Less cost of contract				
Inventory (Opening)	531,667	401,476	537,444	408,798
Purchases	7,260,711	4,850,324	5,383,006	6,473,512
Freight and import duties	14,293	25,157	14,999	25,681
Transportation	8,623	2,398	5,609	4,010
Less closing inventory	435,424	531,667	401,476	537,444
Cost of Contract	7,379,870	4,747,688	5,539,582	6,378,971
-Less direct expenses				
Bonus	89,770	40,140	33,255	59,323
Insurance	63,798	5,791	1,485	5,862

Year Ending September 30th	2007	2006	2005	2004
Exhibitions	55,415	63,656	16,136	28,925
Salaries and wages	606,940	508,713	395,600	454,744
Tender fee	3,200	580	383	341
Motor vehicle upkeeps	76,491	57,431	39,275	44,566
Total	895,614	676,311	486,134	593,761
Total Contract Cost	8,275,484	5,423,999	6,025,716	6,972,732
Profit on Contract	2,412,462	1,569,593	1,135,670	1,284,223
-Other operating income				
Discount received	387	2,623	4,587	4,798
Income from investment	705	731	2,532	2,485
Total	1,092	3,354	7,119	7,283
Less administration cost	1,298,189	872,556	971,830	1,068,200
Profit from operations	1,115,365	700,391	170,959	223,306
Less finance charges	29,263	19,975	25,268	30,042
Profit Before Tax	1,086,102	681,416	143,621	191,464
Income tax	64,310	81,000	-	-
Net Profit for the Year	1,02,793	600,416	143,621	191,464

ADJUSTMENTS TO THE FIRM'S FINANCIALS

Generally accepted valuation practices require the valuation expert to review the financials of the Company along a few key dimensions to determine whether any adjustments should be made to the financials.

Officers and Owners Compensation

Owners of privately held companies have the discretion to set their own compensation. As part of an expert valuation, the compensation of the officers (and owners, if different from the officers) must be reviewed to determine whether his/her/their reported compensation exceeds an estimate of the average officers' compensation for companies in the same industry, of similar size, and located in the same state or city.

If the reported officers' compensation is greater for a company than our estimate of the average officers' compensation for companies in

the same industry, of similar size, and located in the same geographic area, then the amount of the difference is reclassified as profit for the company. This adjustment is the best available proxy for determining how much of officers' compensation is the market-determined salary, and how much, if any, is a dividend for the owner or owners.

Owners of most privately-held firms pay themselves a sum that reflects both the cost of their labor, what is would cost the firm to hire someone of equal skill to do what the owner does, and a variable amount that reflects the return on the owner's business investment.

Other Adjustments for Valuation Purposes

Based on information provided in the valuation interview about owner discretionary spending and other related items, adjustments to company earnings have been made according to generally accepted valuation principles. This results in reducing total expenses for ABC Technology.

Timeliness

Another key dimension of the valuation is timeliness. This means that the ending period for the latest available financial results of the company being valued should be as close to the valuation date as possible. For the valuation of ABC Technology, the ending date of the company financials used for the base year is September 30th, 2007. Based on our review of the timeliness, the financials for ABC Technology used for the valuation adequately reflect the business situation as of February 22nd, 2008.

Using Twelve Months Ending September 30th, 2007 Financials as the Valuation Starting Point

Another key question in this valuation assignment is whether the financial results of ABC Technology for the twelve months ending September 30th, 2007, are generally consistent with the last few years

of financial performance. Although we adjust the input data in a number of significant ways in order to represent the cash generating potential of the firm being valued, the forecasts of future operating profits are based on a starting value, which is constructed from financial statement inputs for the October 1st, 2006 to September 30th, 2007. The natural question is "if the year in question is an exceptionally good or bad year, should adjustments be made to normalize this base value?"

We have reviewed the income statements and balance sheets from the income statements of ABC Technology from 2004 to 2007. We have also reviewed the financial statements for the most recent 12 months ending September 30th, 2007.

We find that the values for the 12 months ending September 30th, 2007, are the most appropriate starting point figures for this valuation for revenue, because these figures are consistent with the recent growth pattern of the firm and its industry. We have adjusted for owner compensation, owner discretionary expenses and other expenses. Consequently, we have adjusted the earnings and EBITDA values used for the valuation as shown in Table 2-2.

Table 2-2: Adjusted Financial Statement for ABC Technology

	Unadjusted (RM)	Amount Adjusted (RM)	Adjusted (RM)
-Revenue			
Contract received	10,687,946	0	10,687,946
-Less Cost of contract			
Inventory (Opening)	531,667	0	531,667
Purchases	7,260,711	0	7,260,711
Freight and import duties	14,293	0	14,293
Transportation charges	8,623	0	8,623
Less closing inventory	435,424	0	435,424
Cost of Contract	7,379,870	0	7,379,870
-Less Direct expenses			
Bonus	89,770	-89,770	0
Insurance	63,798	0	63,798

	Unadjusted (RM)	Amount Adjusted (RM)	Adjusted (RM)
Exhibitions	55,415	-20,000	35,415
Salaries and wages	606,940	0	606,940
Tender fee	3,200	0	3,200
Upkeep of motor vehicles	76,491	-35,000	41,491
Total	895,614	-144,770	750,844
Total Contract Cost	8,275,484		8,130,714
Profit on Contract	2,412,462		2,557,232
-Other operating income			
Discount received	387	0	387
Income from investment	705	0	705
Total	1,092	0	1,092
-Less administration expenses			
Advertisement	1,155	-1,155	0
Allowance for doubtful debts	230,000	-230,000	0
Amortization of R&D cost	70,808	0	70,808
Audit fee	7,000	0	7,000
Bonus	21,780	-21,780	0
Certification fee	15,973	0	15,973
Depreciation	142,312	0	142,312
Directors' remuneration			
Bonus	49,400	-49,400	0
Fee	130,000	-65,000	65,000
Salaries	191,400	0	191,400
EPF contribution	70,767	0	70,767
Gifts and donation	700	-700	0
Insurance	4,915	0	4,915
Legal fee	13,101	-7,00	6,101
License fee	25,152	0	25,152
Medical fee	11,167	-5,000	6,167
Newspapers	1,672	-500	1,172
Postages and stationary	59,199	-10,000	49,199
Rental of premise	6,396	0	6,396
Salaries	118,890	0	118,890
Secretarial and accounting fee	6,389	0	6,389
Socso	10,916	0	10,916

	Unadjusted (RM)	Amount Adjusted (RM)	Adjusted (RM)
Telephone charges	27,839	-7,000	20,839
Training	20,915	-10,000	10,915
Travel expenses	8,432	0	8,432
Water and electricity charges	51,911	-5,000	46,911
Total	1,298,189	-412,035	883,154
Profit from operations	1,115,365		

SECTION

3

The Malaysian Economic Outlook

OVERVIEW

The prospects for the Malaysian economy remain favorable in 2007 despite the uncertainties in the global environment. Strong domestic fundamentals enabled the economy to expand at 6%. On the supply side, output growth is supported by expansion in all sectors of the economy. Meanwhile on the demand side, growth is projected to be driven by resilient domestic demand of both the private and public sectors, largely due to stronger consumer sentiments and business confidence as wells as higher government spending.

The Malaysian economy is anticipated to strengthen further to between 6% and 6.5% in 2008, with positive contributions from all sectors of the economy. Domestic demand is projected to be the main driver of the economy while external demand is expected to pick up in tandem with improved prospects in global trade. Both private investment and consumption are expected to remain robust, while public expenditure continues to expand. Finally the Malaysian economy is expected to remain resilient on the back of a well diversified and broad-based structure, as well as strong macroeconomic fundamentals, which have strengthened over the years.

PUBLIC SECTOR FINANCE

Fiscal Policy

Fiscal policy continues to assume a significant role in supporting economic growth. The public sector's contribution to aggregate demand remained high at 24.9% of Gross Domestic Product (GDP) in 2007, while its contribution to Real GDP growth is expected to 2.4 percentage points.

The fiscal stance adopted by the Government is in response to the demands of the economy and in line with sound macroeconomic management objectives. The budgetary programs and projects remained focused on generating activities that support new sources of growth, provide private business initiatives, improve overall economic efficiency as well as enhance the standard of living. In addition, measures are being taken to move the economy up the value chain as well as develop skilled, innovative and knowledgeable human capital.

Government Development Expenditure

Government development expenditure totaled RM40,870 million in 2007. The economic services sector receives the largest allocation of RM19,124 million or 46.8% of total development expenditure.

Our Conclusion

We estimate that the Malaysian economy will continue to expand, thereby enhancing economic activities by the private and government sectors. Modernization programs implemented by the Government will benefit ICT companies such as ABC Technology, which has developed a strong reputation among Government sector organizations.

SECTION

4

The Industry Outlook

PROSPECTS AND OUTLOOK OF THE ICT INDUSTRY IN MALAYSIA

The ICT industry began in the 1950s. Over the span of five decades, the ICT industry has undergone several waves of change and growth brought by new revolutionary technology. Each wave of change is marked by tremendous increase in the industry revenue as well as the scope of ICT usage. From its initial role as supporting business function, it has pervaded every aspect of every day living.

ICT expenditure is earmarked as one of the driving forces to transform Malaysia into a knowledge-based economy and a developed nation by 2020. Malaysia's ICT spending grew as estimated 7.7% to RM32.2 billion in 2005 from RM29.9 billion in 2004. According to the Association of Computer and Multimedia Industry of Malaysia (PIKOM), total technology expenditure in Malaysia is expected to record RM45 billion in 2008. By sector, manufacturing remains the largest spender on ICT followed by the consumer, finance and business services and Government sector. Further details on ICT expenditure by different sectors are shown in Table 4-1.

Table 4-1: ICT Expenditure by Sector (RM million)

Sectors	2000	2004	2005
Agriculture	200	128	138
Mining	222	224	234
Manufacturing	12,188	13,652	14,367
Utilities	378	430	470
Construction	112	126	135
Wholesale and retail	1,585	1,735	1,870
Transports and communication	1,221	1,581	1,770
Finance and business services	1,894	2,563	2,845
Government	1,389	1,981	2,245
Consumers	6,314	7,440	8,104
Other services	140	62	70
Total	25,643	29,922	32,248

Source: Ninth Malaysia Plan

Locally, export of systems has also grown from an estimated RM28.1 million in 2004 to approximately RM211.9 million in 2005. Some of the key export destinations include the US, Korea, China, Germany and Hong Kong.

In addition to the local market, numerous market opportunities can be found in developing countries such as Thailand, Indonesia and Vietnam. The countries have similar traits to Malaysia, namely growing economies, sizeable presence of multinational corporations and companies predominantly SMEs. The Government sectors are also modernizing, creating demands for ICT products and services.

Another survey by Austrade, a trade organization of the Australian Government, showed that the market for information technology services in Malaysia was estimated to be US$2.9 billion (1US$ equals RM3.2) in 2005, and would grow to US$4.8 billion in 2010.

Determining the Appropriate Growth Segment for ABC Technology

The choice of the growth segment going forward for ABC Technology involves several considerations. The ICT industry has recovered from its downturn and has experienced a healthy growth of 7.0% per annum in 2005 and 2006. We expect the trend to continue. As to ABC Technology, we expect the company to record higher than industry average growth as it serves the government sectors, which are expected to increase spending on ICT capital expenditure.

The long-term or terminal growth rate for ABC Technology is 4.0%, which is consistent with the average long-term economic growth of the Malaysian economy of 4 to 6%. The long-term growth rate generally has a larger impact on the total valuation results than the near-term projection. After careful consideration, we have chosen the moderate growth segment as the best measure for the discounted free cash flow valuation method for ABC Technology.

ICT Industry's Barrier of Entry

The ICT industry is characterized by high competition in the low and commodity- type computer services sector and limited competition in the technology-intensive computer services sector. ABC Technology, which specializes in traffic management systems face limited competition as the sector is technology intensive. The barriers to entry in the technology intensive computer sector can be summarized as follows:

1. Domain knowledge

   Having the appropriate domain knowledge in the specific industry and application is crucial and serves as a barrier to entry to new and potential entrants. Domain knowledge is a general term to describe knowledge and skills that a software program encodes. Application specific domain knowledge can only be acquired through close interactions with the software users of a specific application market.

2. The cost effective delivery model

- Development cost

Software development is characterized by substantial economies of scale. The fixed costs of producing software, including applications, are high. By contrast, marginal costs are very low. Moreover, the costs of developing software are "sunk"- once expended to develop software, resources so devoted cannot be used for another purpose. The result of economies of scale and sunk costs is that application developers seek to sell as many applications as possible. In this respect, the more competitive the environment, the more difficult it would be to enjoy economies of scale in the short-term. A new entrant has to have quite substantial amount of working capital and stamina to sustain in the highly competitive environment before path of profitability starts to flow in.

- Other sunk costs

New entrant often incur various start-up costs, such as acquiring market information, developing and testing product designs, including equipments, engaging personnel and setting-up distribution systems. Potential entrants may also face significant sunk cost due to the needs to:

i. Make investment in market specific assets and in learning how to organize the use of these assets.
ii. Overcome product differentiation-related advantages enjoyed by incumbents.
iii. Overcome disadvantages presented by the strategic behavior of incumbents.

These potential sources of sunk costs can create significant impediments to entry when they require that potential entrants factor greater costs into the decision-making relative to incumbents who can ignore such costs in their pricing decisions because they have already made their sunk costs commitments.

The investment required in establishing a reputation as a reliable or quality supplier is also a sunk cost and can constitute a barrier to entry and a crucial element in attracting buyers, particularly in a service oriented industry like software. Under these circumstances, the time to gain a reputation may make profitable entry more difficult and hence delays the competitive impact that the entrants may have in the marketplace.

3. R&D activities

In the rapidly evolving ICT environment, especially in the growing segments, products have a relatively short shelf life. External and internal business processes and methodologies are ever changing, coupled with continuous innovation, regular upgrades of components, an organization’s competitiveness and creation of a barrier of entry is dependent on R&D and anticipating the needs of customers.

Continuous R&D coupled with market acceptance of an organization’s products and services serve a high barrier to new and potential entrants.

4. Long-term relationship and business sustainability

The ability of an organization to develop and maintain long-term and strong relationship with its customers is vital as it forms another barrier to new and potential entrants for the continuity and sustainability of the business. Long-term relationship also results in high switching cost for customers looking to switch service providers which have already entrenched in the customers’ establishment and offering a variety of solutions. The ability to ensure business continuity is important as the design, development, roll out and implementation of software and services requires on-going support and maintenance.

5. Knowledge workers

   The shortage of qualified and experienced workers remains one of the key barriers of entry for new and potential entrants into the ICT industry. Knowledge workers such as programmers, software engineers, system architects and content developers with high level of competence and skills are in short supply.

FACTORS AFFECTING PERFORMANCE OF ICT DEMAND IN GOVERNMENT SECTOR

According to the Ninth Malaysia plan, the Government ICT capital expenditure in 2005 was estimated to be more than RM2.2 billion. The Government has announced that it will continue to modernize the public sectors, the defense sectors and local government sectors to improve the delivery of services to the citizens.

The continued emphasis on ICT expenditure by the Government will benefit ABC Technology significantly. This is due to the following factors:

- ABC Technology is a preferred Bumiputra company for ICT projects. ICT projects can be secured through direct negotiation with the Government that will allow higher profit margin.
- ABC Technology has the track records of completing Government ICT projects and will likely be invited to participate in future Government ICT projects.
- ABC Technology is involved in higher knowledge-intensity ICT projects such as computer security and defense security that will allow higher profit margin.
- ABC Technology is among the few successful Bumiputra-owned ICT companies in Malaysia. The Government policy of nurturing Bumiputra companies to be involved in high technology will benefit ABC Technology in the medium term.

Based on the current financial performance of the Company, the profit margin has been maintained at 69% of contract value. The Company is expected to realize higher profit margins as it is involved in more knowledge-intensive ICT projects secured from the Government.

SECTION 5

Other Key Valuation Factors Cost of Capital, Liquidity Discount and Control Premium

COST OF CAPITAL AND EXPECTED RATE OF RETURN

Risk and Return

Important factors in determining the value of a company are the growth in operating profits and rate of return that investors require. The rate of return investors require depends on a number of factors, all of which relate to how risky they believe the company to be. The greater the risk or uncertainty about the expected operating profit growth, the greater the return investors require compensating them for taking this risk. This relationship has been borne out time and time again by researchers.

This incremental return is the incremental reward that investors receive for taking the risk of investing in risky assets like a portfolio of stocks, rather than in riskless Malaysian Government Bond.

For the valuation of ABC Technology, we must calculate its cost of capital. This is the return investors require, if the firm was a public

company. An adjustment for the fact that this firm is a private company is made later in the form of a liquidity discount.

Calculating the Firm-Specific Cost of Capital

The cost of capital for ABC Technology is constructed from factors related to economy-wide indicators, to industry and size-specific measures, and to the firm-specific debt to equity ratio. By combining sophisticated financial risk analysis and credit scoring with historical estimates of risk factors makes it possible for us to generate a firm-specific cost of capital measure, as shown in Table 5-1.

Table 5-1: Calculating the Cost of Capital for ABC Technology

Cost of Capital Component for ABC Technology	
Cost of Common Equity and Its Components	
Interest on 1 Year Malaysian Treasury Bill	3.36%
Stock market risk premium	7.5%
Beta for small listed firms	1.4
Cost of Common Equity	13.86%
Cost of Long and Short-Term Debt	
Cost of Long-Term Debt (Shareholders' Advance)	0%
Debt to (Debt plus Equity) Ratio	
After-tax Weighted Average Cost of Capital	13.0%

For this valuation, we also consider firm-specific non-financial risk in determining the cost of equity for this firm. The results of this review are shown in Table 5-2.

Table 5-2: Firm-Specific Non-Financial Risk for ABC Technology

Firm-Specific Non-Financial Risk for ABC Technology		
Risk Concept	**Measurement**	**Assessment**
Business Stability	How long has the company been in business 1-3 Years-High Risk: 4-6 Years-Moderate Risk: More than 6 Years-Low Risk	Low risk
Business Transparency	Does the firm produce an audited financial statement at least once a year? Yes-Low Risk: No-High Risk Low Risk	Low risk
Customer Concentration	Does the firm receive more than 30% of its revenue from less than five customers? Yes-High Risk: No-Low Risk	Low risk
Supplier Reliance	Can the firm change supplier without sacrificing product quality or increasing cost? Yes-Low Risk: No-High Risk	Low risk
Reliance on Key People	Are there any personnel critical to the success of the business that cannot be replaced in a timely manner at the current market wage? Yes-High Risk: No-Low Risk	High Risk
Intensity of competition	What is the intensity of competition Very Intense-High Risk Moderately Intense-Moderate Risk Not Very Intense-Low Risk	Moderate Risk

TWO KEY VALUATION ADJUSTMENTS FOR THIS FIRM

There are two important adjustments that should be made in the valuation of a privately-held firm when the valuation is centered on the total business entity. These are the liquidity discount and the control premium. In any valuation where these adjustments are made, it is important to understand the rationale for making these adjustments and the basis on which a valuation expert selects the values to use in making these adjustments. These adjustment factors can be large, often raging from 20% to 45% of the total business value before adjustment. Our calculations of the liquidity discount and control premium for ABC Technology are described in the following sections.

The Liquidity Discount

The liquidity discount reduces the ownership value to reflect the fact

that the ownership interest cannot be easily sold. Any potential buyer of the ownership interest value faces the risk that he/she cannot sell the ownership interest in a timely way because there are a limited number of potential buyers. This is to be contrasted to shares of stock that trade on Bursa Malaysia. These shares can be readily purchased and sold and, except for rare cases, the price received will reflect the fair market value of these shares. Thus, the liquidity discount reflects the additional risk that the buyer faces because he/she may not be able to receive a price that would be obtained if ownership interest in ABC Technology were sold in a highly liquid market.

Based on our review of the literature research on liquidity discount namely in the US, we believe the appropriate value to use for the average private company discount is 20%.

The Control Premium

The control premium is an additional sum that an investor would pay above the fair market value of a minority interest of the firm in question. In our computation of the control premium, we first calculate the minority interest ownership value of ABC Technology. We then factor up this value to reflect a control premium.

There are multiple factors that give rise to a control premium. They include:

- The ability of the owner to manage cash flow of the firm in a way that is consistent with life style and family responsibilities.
- The nature and magnitude of business of non-operating assets.
- The quality of management.
- Synergies between the buying and target firm. These might include removal of overlapping functions and therefore reducing expenses per Ringgit of revenue.
- Taking advantage of growth opportunities that would either not be possible or highly expensive to take advantage of without purchasing the assets of the target firm.

The approach we use to estimate the control premium for this firm reflects several factors and is based on experiences in the US. They include the firm's business risk, which is directly related to its industry as well as the firm's size and capital structure. As a general rule, most business appraisers apply a median mark-up value to the minority equity value to obtain the majority equity value. The source of this median value and related control premium statistic is the *Annual Mergerstat Review*. The data collected by Mergerstat showed the median values of control premium ranged between 35% to 27%.

Based on our literature survey on control premium, we use a control premium of 20% for our valuation of ABC Technology reflecting a more conservative value of a control premium. This is consistent with the fact that ABC Technology is not a large firm.

SECTION

6

Valuation Findings

APPROACH TO VALUATION OF THIS FIRM

The US Internal Revenue Service (IRS) has established guidelines for conducting a proper business valuation. These guidelines have listed the factors that should be considered when doing a business valuation which are as follows:

- The nature of the business and history of the enterprise from its inception.
- The industry outlook in general and the condition and outlook of the specific industry the firm is in.
- The financial condition of the business.
- The earnings and dividend capacity of the company.
- Whether or not the company has good will or other intangible value, like patents for example.

- Whether the whole company or only a minority interest in the company being valued.

- The market prices of stock of companies engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange, like Bursa Malaysia.

Defining Fair Value

The most widely accepted standard for valuing a closely held business is fair market value. We apply a valuation method that we believe is consistent with the standard of fair market value established by the US IRS. The American Society of Appraisers has defined fair market value as the amount at which a property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts".

VALUATION FUNDAMENTALS

A business valuation is an analytical process for estimating the price a willing buyer would pay for a business and a willing seller would accept-without having to actually sell the business. Many commentators have noted that business valuation is both an art and a science, since there are subjective factors that must be considered along with objective information in this analytical process.

Value as an On-Going Concern

The first issue to be addressed is whether the valuation is for a business as an-going concern, or a business in liquidation. For an on-going business, the objective of the valuation is to analyze the company from a prospective buyer's perspective, i.e., what is the likely flow of earnings from this company. For a business in liquidation, the value of the business is the market price of its assets minus its liabilities. For ABC Technology, this is a valuation as an on-going concern.

Valuation Method

Valuation analysts have developed several methods that can be used to value an on-going concern. These methods can be grouped into two categories: market-based and income-based methods. Market-based methods use measures of revenue and EBITDA valuation multiples from comparable companies. For public company comparables, the information is readily available on the value of these companies from the stock exchanges. For private companies, the source of comparables is recent private company sales. Income-based methods use estimates of future earnings discounted back to the present using a cost of capital for the company being valued.

Every valuation methodology has its own set of assumption necessary to develop this proxy for fair market value. For example, the valuation method of using market prices from private sales of comparable companies has two key assumptions that must be met for the resulting valuation to be accurate. First, the firm to be sold and the firm being valued must be similar in their business size and performance. Second, the sale should be very recent date of the valuation, so the external conditions that influence valuations are approximately the same.

In practice, these two assumptions are difficult to validate. Many private transactions are not reported, while some that are reported have some seller or third party financing involved which complicates measuring the actual value. Assessing comparability of the businesses can also be challenging for many type of businesses.

A second assumption for the public company comparables is that the operating characteristics of the business being valued are similar to the characteristics of the public companies. A third assumption is that the capital structure of the business being valued is similar to the capital structure of the public companies. In practice, these assumptions are difficult to validate in a valuation.

Income-based methods of valuation include capitalized earnings,

excess earnings, discounted cash flow, and discounted free cash flow. Each of these valuation methodologies has its set of assumptions and necessary inputs. The accuracy of these methods is dependent upon how well the assumptions are met and the accuracy of the inputs. Since each valuation assignment is unique, it is important to keep an open mind about which method or set of methods will be best suited for the assignment. However, it is also important to track how well different methods perform in predicting what the actual price will be when a business is sold.

OUR APPROACH TO VALUATION OF THIS FIRM

We have used multiple methods to generate valuation estimates for this firm. The first method described is the discounted free cash flow method.

The Discounted Free Cash Flow Forecasting Valuation Method

For the discounted free cash flow forecasting, there are key assumptions that must be made in order to develop a reliable valuation. This approach relies on the assumption that a reliable estimate of future cash flows can be generated for a company, and on the assumption that the risk characteristics of the company can also be estimated.

DISCOUNTED FREE CASH FLOW VALUATION OF THE FIRM

We have evaluated and forecasted the revenue, cash flow, and financial risk outlook for the IT and telecommunication industry using various databases and market research reports on the industry in Malaysia.

We then compute the total fair market value of ABC Technology. The fair market value is what a willing buyer should pay a willing seller for total control of the business.

The total fair market value for ABC Technology is RM17,500,000. The ownership composition of that estimate is shown in Table 6-1. The valuation results reported are as of February 22nd, 2008.

Table 6-1: Value by Ownership Component (in RM)

	Equity Component	Value
Ownership Equity		
-Minority Value	14,172,310	
-Additional Value due to Control	+ 2,834,462	
-Total Ownership Equity		17,006,772
Preferred Equity		-
Total Debt (Book value)		470,000
Other liabilities		-
Estimated Fair Market Value		17,476,772
Rounded off		17,500,000

Ownership Equity is defined as total value less the book values of preferred equity holdings, short and long-term debt and long-term liabilities. Ownership Equity divided by the number of ownership shares outstanding equals the fair market value per share of the outstanding equity for ABC Technology.

The minority value of equity is RM14,172,310. This is what the equity of ABC Technology is worth to a buyer who has a right to the firm's cash flow but does not have control over how the firm's assets are used to produce this cash flow.

A summary of the intermediate values used to determine the discounted free cash flow valuation is shown in Table 6-2.

Table 6-2: Valuation Calculation Summary for Discounted Cash Flow Method

After Tax Weighted Average Cost of Capital	13%
Present Value of Free Cash Flow to Firm (FCFF) after factoring in Net Capital Expenditure and Change in Working Capital for years 2008 to 2012	
Year 2008	RM853,547
Year 2009	RM974,635
Year 2010	RM1,062,515
Year 2011	RM1,105,574
Year 2012	RM1,130,107
Terminal Value	RM13,059,009
Sum of Present Value of FCFF plus Terminal Value	RM18,185,387
Excess Cash	-
Sum on Non-Operating sources of value	-
After Tax Total Value	RM18,185,387
Total Debt (Shareholders' advance)	RM470,000
Minority ownership value before control premium and liquidity discount	RM17,715,387
Loss of ownership value due to liquidity discount of 20%	RM3,543,077
Minority ownership value	RM14,172,310
Gain in ownership value due to control premium of 20%	RM2,834,462
Total ownership equity	RM17,006,772
Total debt	RM470,000
Total fair market value	RM17,476,772
Rounded off	RM17,500,000

Liquidity Discount and Control Premium

Since the firm is private, this value reflects a discount of 20% from what the shares would hypothetically sell if they are traded in the public market; this is called the Liquidity Discount. The additional value due to control is RM2,834,462. This value reflects the premium above the minority equity value that a buyer would pay for the right for majority control of ABC Technology and the firm's assets. The impacts of these two adjustments are shown in Table 6-4.

Table 6-4: The Impact of Control Premium and Liquidity Discount on Ownership Value

Adjusting Ownership Value for Control and Liquidity	Value (RM)
Minority Ownership Value	
Value Before Control and Liquidity Discount	17,715,387
Loss of Ownership Value due to Liquidity Discount-20%	3,543,077
Minority Ownership Value after Liquidity Discount	14,172,310
Gain in Ownership Value due to Applying Control Premium- 20.0%	2,834,462
Final Estimated Ownership Value	17,006,772

Factors Impacting the Discounted Free Cash Flow Valuation

The valuation results are dependent on the following set of factors:

- The nature of the business and its current financial condition based on the latest company financial information.

- The economic outlook in general and the prospects for the firm's industry.

- Cash flow from identified non-business operations is valued separately from cash flow streams associated with primary business operations.

- The expected cash flow growth of the industry over the next five years, and the on-going growth expectation.

- The rate of return investors require for owning a business that has a risk profile similar to this firm.

- A liquidity discount applied to the initial value reflecting the fact that there are a limited number of buyers for this firm.

- A premium added to the calculated initial value reflecting the fact that the new owner has a controlling interest in firm purchased

as opposed to a minority interest. A controlling or a majority interest in the firm is more valuable than a minority interest. The reason is that controlling interest confers the right on the controlling buyer to make decisions about how the assets of the business are to be used. A minority interest does not confer this right and therefore is less valuable. A minority interest only confers on the minority owner the right to his/her pro-rata share of the firm's earnings.

VALUATION METHOD: MARKET MULTIPLES

In the valuation method using market multiple, we have categorized ABC Technology among a group of ICT companies which are listed on MESDAQ market of Bursa Malaysia. This comparison will allow us to value ABC Technology as if it is a public company.

Table 6-5 shows ICT companies listed on MESDAQ market which are compared with ABC Technology using market multiple.

Firms	Sales (RM)	Profit from Operation (RM)	EBITDA (RM)	Shares Outstanding	Price per Shares (RM)	Market Value (RM)
Firm 1	17,922,037	1,722,974	2,035,900	105,646,000	0.070	7,395,220
Firm 2	15,630,781	1,738,691	2,851,903	104,400,000	0.15	15,660,000
Firm 3	15,887,018	5,343,883	5,647,233	98,511,060	0.76	74,868,405
Firm 4	46,735,713	7,542,531	9,190,392	124,182,533	0.42	52,156,663
Firm 5	10,572,799	4,221,712	6,192,636	121,216,000	0.47	56,971,520
Firm 6	57,840,393	10,233,675	11,279,888	212,798,000	0.26	55,327,480
Firm 7	38,107,050	10,859,767	12,848,129	200,000,000	0.21	42,000,000
Firm 8	39,445,000	8,881,000	9,422,000	248,000,000	0.195	48,360,000

Table 6-6 shows financial comparison of the peer group with ABC Technology.

Company	Sales (RM)	EBITDA (RM)	Price per Shares (RM)	Market Value (RM)	Market Value derived by Sales (RM)	Market Value derived by EBITDA (RM)
ABC Technology	10,686,946	1,328,946	-	-	-	-
Firm 1	17,922,037	2,035,900	0.07	7,395,220	0.41	3.63
Firm 2	15,630,781	2,851,903	0.15	15,660,000	1.00	5.49
Firm 3	15,887,018	5,647,233	0.76	74,868,405	4.71	13.26
Firm 4	46,735,713	9,190,392	0.42	52,156,663	1.12	5.68
Firm 5	10,572,799	6,192,636	0.47	56,971,520	5.39	9.20
Firm 6	57,840,393	11,279,888	0.26	55,327,480	0.96	4.90
Firm 7	38,107,050	12,848,129	0.21	42,000,000	1.10	3.27
Firm 8	39,445,000	9,422,000	0.195	48,360,000	1.23	5.13
Average for MESDAQ software firms					1.99	6.32

While there is general comparability between the product mix of ABC Technology and that of peer firms, the differences in the scale of operations between the public companies and ABC Technology limit the use of operating financial comparisons. In addition, ABC Technology is dependent on the public sector while the peer group has a diversified customer base.

After a careful review of product mix and financial characteristic differences between ABC Technology and the peer group firms, we concluded that both revenue and earnings-based market multiples are appropriate to develop a market method fair market value.

Valuation Using Revenue Market Multiples

We have generated a public company, revenue multiple valuation result for ABC Technology. The steps in the process and the final result are shown in Table 6-7.

Table 6-7: Valuation by Public Company Comparable Method – Revenue Multiple

Market Method Valuation Findings based on Revenue Multiple for Public Company Comparables	
1. Revenue for valuation purposes Multiply by:	RM10,687,946
2. Average of public company market value to revenue basis Equals	1.99
3. Fair market value of ownership equity-public company basis Minus	RM21,269,012
4. Liquidity discount for privately-held firm (line 3 multiplied by liquidity discount factor of 20%) Equals	RM4,253,802
5. Fair market value of ownership equity-private company basis Plus	RM17,015,210
6. Control premium (line 6 multiplied by control premium percentage by 20.0%) Equals	3,403,042
7. Fair market value of ownership equity Plus	RM20,418,252
8. Debt (shareholders' advance) Equals	RM470,000
9. Total fair market value-market method of valuation – revenue multiple Rounded off	RM20,888,252 RM20,900,000

Valuation Using EBITDA Market Multiples

In addition, we have also generated a public company, EBITDA multiple valuation result for ABC Technology. The steps in the process and the final result are shown in Table 6-8.

Table 6-8: Valuation of Public Company Comparable Method – EBITDA Multiple

Market Method Valuation Findings based on EBITDA Multiples for Public Company Comparables	
1. Revenue for valuation purposes Multiply by:	RM1,328,485
2. Average of public company market value to EBITDA ratio Equals	6.32
3. Fair market value of ownership equity-public company basis Minus	RM8,396,025
4. Liquidity discount for privately-held firm (line 3 multiplied by liquidity discount factor of 20%) Equals	RM1,679,205
5. Fair market value of ownership equity-private company basis Plus	RM6,716,820
6. Control premium (line 6 multiplied by control premium percentage by 20.0%) Equals	RM1,343,364
7. Fair market value of ownership equity Plus	RM8,060,184
8. Debt (shareholders' advance) Equals	RM470,000
9. Total fair market value-market method of valuation – revenue multiple Rounded off	RM8,530,184 RM8,500,000

Weighting the Valuation Methods

To determine a final value for the minority ownership interest in ABC Technology, we have carefully considered the degree to which the facts of this assignment are consistent with the key assumptions of the methods of valuation used in this assignment, public company market multiples and discounted free cash flow. It is our judgement that the public companies available for use as comparables are of limited use as comparables due to the significant differences in size compared to ABC Technology. ABC Technology is highly dependent on the Government sector for its revenue compared to the peer group. There are no facts

in this assignment that limit the appropriateness of the discounted free cash flow method to the valuation of ABC Technology.

Accordingly, we have assigned the weights as shown in Table 6-9 to the valuation results generated by the different methods employed in this assignment.

Table 6-9: Weighting of Different Valuation Results

Valuation Method	**Weight**
Discounted Cash Flow Method	60%
Public Company Comparable-Market value to revenue multiple	20%
Public Company Comparable-Market value to EBITDA multiple	20%
Sum of the valuation weight	100%

ACCOMPANYING INFORMATION

1. ABOUT BISON CONSULTING

   Bison Consulting is a leading consultancy company specializing in technology market research, intellectual property right valuation, business valuation and technology strategy. It helps young companies to raise capital from investors and venture capital firms. It also specializes in preparing submissions for application of government technology grants.
   Its major clients include universities, research institutes and private companies.

2. PROFESSIONAL QUALIFICATIONS OF APRAISER

   Dato' Anuar Md. Nor
   - Master of Business Administration (MBA), University of Bradford, England.
   - MSc Management of Technology, Massachusetts Institute of Technology, USA.
   - BSc Chemical Engineering, University of Birmingham, England.
   - Lecturer, Venture Capital Management, International Business School, Universiti Teknologi Malaysia.
   - Experienced venture capitalist.
   - Managing Director, Bison Consulting.

3. CERTIFICATION AND CONDITIONS

   We hereby certify the following statements regarding this business valuation:

We have not personally inspected the assets, properties, or business interests encompassed by this appraisal.

- We have no present or prospective future interest in the assets, properties, or business interests that are the subject of this business valuation.

- We have no personal interest or bias with respect to the subject matter of this report or the parties involved.

- Our compensation for making the appraisal is in no way contingent upon the value reported or upon any predetermined value.

- To the best of our knowledge and belief, the statements of facts contained in this report, upon which the analyses, conclusions, and opinions expressed herein are based, are true and correct.

- Subject to certain limitations the reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the Code of Professional Ethics and the Standards of Professional Appraisal Practice of The Appraisal Institute, of the American Society of Appraisers, and of the other professional organizations, unless otherwise stated.

- We have performed a historical analysis of the business's financial statements.

- We assume that the financial and related information supplied by the firm's representative reflects the normal operation of the business. To the extent this is not an accurate representation, the analysis and conclusions drawn are not valid and shall not be represented in any context that implicitly or explicitly suggests that we and our representatives believe the business valuation to be accurate.

4. STATEMENT OF CONTINGENT AND LIMITING CONDITIONS

This appraisal is made subject to these general contingent and limiting conditions:

- We assume no responsibility for the legal description or matters including legal or title considerations. Title to the subject assets, properties, or business interests is assumed to be good and marketable unless otherwise stated.

- The subject assets, properties, or business interests are appraised free and clear of any or all liens or encumbrances unless otherwise stated.

- We assume responsible ownership and competent management with respect to the subject assets, properties, or business interests.

- The information furnished by others is believed to be reliable. However, we issue no warranty or other form of assurance regarding its accuracy.

- We assume no hidden or unapparent conditions regarding its accuracy.

- We assume that there is full compliance with all applicable federal, state, and local regulations and laws unless the lack of compliance is stated, defined, and considered in the appraisal report.

- We assume that all required licenses, certificates of occupancy, consents, or legislative or administrative authority from any local, state, or national government, or private entity or organization have been or can be obtained or reviewed for any use on which the opinion contained in this report is based.

- Unless otherwise stated in this report, we did not observe, and we have no knowledge of, the existence of hazardous materials with regard to the subject assets, properties, or business interests. However, we are not qualified to detect such substances. We assume no responsibility for such conditions or for any expertise required to discover them.

- Possession of this report does not carry with it the right of publication. It may not be used for any purpose by any person other than the client whom it is addressed without our written consent and, in any event, only with proper written qualifications and only its entirety.

- We, by reason of this opinion, are not required to furnish a complete valuation report, or to give testimony, or to be in attendance in court with reference to the assets, properties, or business interests in question unless arrangements have been previously made.

- Neither all nor any part of the contents of this report shall be disseminated to the public through advertising, public relations, news, sales, or other media without our prior written consent and approval.

- The analyses, opinions, and conclusions presented in this report apply to this engagement only and may not be used out of context presented herein. This report is valid only for the effective date specified herein and only for the purpose specified herein.

Appendix 1

The Entrepreneur's Due Diligence Business Information Kit for Private Equity Proposal

General Information

- Marketing Plan
- Products and Services
- Distribution and Sales Forecast
- Amount of financing sought and projected use of the proceeds
- Resumes of directors and all senior officers

Corporate Information

- Certificate of incorporation and M&A of company
- Shareholders, option holders and bond holders
- List of directors and officers, directors' fee, present salaries and amount of stock holders
- Copies of employment contracts and other benefits received by directors and senior staffs
- List of current or pending legal problems or lawsuits
- List of principal finance companies and banks

Employees and Compensation Information

- List of employees, duties, and salary of each
- List of contract staffs
- Employment benefits
- Information of union activity

Asset Information

- Address and description of all plants, leases, contracts, titles, appraisal, tax paid
- Description of age of machinery, leased or owned
- List of assets

Trademark, Patents and Copyright Information

- List of trademarks, number, dates of registration
- List of patents
- List of copyrights
- List of royalty
- List of patents and trademarks pending

Contracts and Commitment

- List and details of all contracts and commitments which may bind the company in any way
- Copies of signed letter of intents, agreements and contracts

Financial Documentation

- Profit and loss statement and balance sheet of the company and subsidiaries of past three years and current year
- Copies of credit report of the company
- Copies of tax returns for the past five years
- Copies of insurance policies
- Schedule of dividends paid in the past five years
- Copies of annual company returns

Products/Services Information

- List of all products and current sales volume and profit margin of each product
- Analysis and data on future competition
- Unit cost of products and possible future cost increases
- List of important raw materials and suppliers
- Corporate break-even point, details of product mix, and fixed and variable expenses
- List of commitments to purchase materials long and short -terms

- List of major suppliers
- List of major customers
- Copies of services or product warranties
- Names of important trade journals read by the company

Selling Prices and Sales Outlets

- Price breakdown of each product, payment terms, other discounts, service and returns
- List of sales outlets and complete information on each one
- Sales statistics for the past five years by significant categories
- List of major competitors

Advertising Information

- Details of advertising activities of the company
- Results of any survey and market research studies done, formal and informal

Miscellaneous Information

- Newsletter and magazine articles about the company and its products/ services
- Advertising brochures and manuals designed for clients and consumer use
- Product samples
- Policy and procedural manuals

Appendix 2

Guidelines for Commercialization Plan

Eligibility Criteria

1. The applicant must be a Malaysian SME;
2. The R&D and prototype must have been completed successfully;
3. The proposed project must be for commercialization of a tangible product.

The Commercialization Plan should contain the following information and sections.

1. Executive Summary of the proposed project
2. Shareholders of the applicant
3. Capabilities of the applicant
   - Number of employees
   - Key management
   - Curriculum vitae of key employees
4. Proposed activity
   - Project title
   - Project objectives
   - Status of proposed project
   - Project schedule and milestones
5. Description of technology
   - Background of the main technology of the proposed project
   - Description of the technology, products and process
   - Technology applications
   - Competing technologies

- Manufacturing and process flow
- Manufacturing volume or capacity

6. Local R&D collaborator
    - Name of organization
    - Details of R&D collaboration
    - Gantt chart of the R&D collaboration program
7. Description of R&D undertaken for the proposed project
    - Background of R&D activity
    - Aims of the R&D activity
    - Product description and features
    - Details of R&D results achieved
    - Key R&D personnel
    - Amount spent on R&D
    - Technology ownership
    - Intellectual property ownership
8. Market and business aspects
    - Market analysis
    - Marketing strategy
    - Market success factors
    - Competitors in the local and world markets
9. Financial information
    - Profit and loss statements
    - Cash flows statement
    - Projected income of the proposed project

Source: MTDC

Appendix 3

Major Malaysian Private Equity Firms

Aris Venture Sdn Bhd
30, Jalan Kenari 17C, Bandar Puchong Jaya, 47100, Puchong, Selangor,
Tel: 603 8076 3063
Preferred investment stage: Mezzanine and Pre-IPO

AmPrivate Equity Sdn Bhd
Level 8, Bangunan Ambank Group, 55, Jalan Raja Chulan, 50200, Kuala Lumpur
Tel: 603 2078 2392
Preferred investment stage: Mezzanine and Pre-IPO

Banyan Ventures Sdn Bhd
Suite A3A07, Block A, Phileo Damansara 1, No. 19, Jalan 16/11, 46350, Petaling Jaya, Selangor
Tel: 603 7966 8108,
Preferred investment stage: Expansion, mezzanine and Pre-IPO

Bumiputera and Technology Venture Capital Sdn Bhd
Level 12, Menara Boustead, Jalan Sultan Ahmad Shah, 10500 Penang
Tel: 604 227 4297
Preferred investment stage: Mezzanine and Pre-IPO

CMS Opus Private Equity Sdn Bhd
Level 33 (Suite A), Menara MAXIS, Kuala Lumpur City Centre, 50088 Kuala Lumpur
Tel: 603 2031 9008
Preferred investment stage: Expansion, mezzanine and Pre-IPO

Commerce Technology Venture Sdn Bhd
No. 6, Commerce House, 22-24, Jalan Sri Semantan Satu, Damansara Heights, 50490, Kuala Lumpur
Tel: 603 2732 5577
Preferred investment stage: Start-ups, mezzanine and Pre-IPO

DTA Growth Capital Sdn Bhd
No. 24A, Jalan Datuk Sulaiman, Taman Tun Dr. Ismail, 60000 Kuala Lumpur
Tel: 603 7722 2560
Preferred investment stage: Mezzanine and Pre-IPO

Ethos Capital One Sdn Bhd
Level 8, Menara TSH, Jalan Semanta, Damansara Heights, 50490 Kuala Lumpur
Tel: 603 2093 6111
Preferred investment stage: Mezzanine and Pre-IPO

Expedient Equity Ventures Sdn Bhd
Level 11, Menara Bank Pembangunan, Bandar Wawasan, No. 1016, Jalan Sultan Ismail, 50300 Kuala Lumpur
Tel: 603 2050 3000
Preferred investment stage: Seed, start-up and expansion

FirstFloor Capital Sdn Bhd
7th Floor, PNB Damansara, 19, Lorong Dungun, Damansara Heights, 50490 Kuala Lumpur
Tel: 603 2093 4044
Preferred investment stage: Expansion, mezzanine and Pre-IPO

Kumpulan Modal Perdana Sdn Bhd
Suite 7.02, Level7, The Gardens South Tower, MidValley City, Lingkaran Syed Putra, 59200 Kuala Lumpur
Preferred investment stage: Seed, start-up, expansion, mezzanine and Pre- IPO

Malaysian Technology Development Corporation Sdn Bhd
Level 8-9, Menara Yayasan Tun Razak, Jalan Bukit Bintang, 55100 Kuala Lumpur
Tel: 603 2172 6000
Preferred investment stage: Seed, start-up, expansion, mezzanine and Pre-IPO

Malaysian Venture Capital Management Berhad
Level 10, Menara Bank Pembangunan, 1016, Jalan Sultan Ismail, Bandar Wawasan, 50300 Kuala Lumpur
Tel: 603 2050 3000
Preferred investment stage: Seed, start-up, expansion, mezzanine and Pre-IPO

Mayban Venture Capital Company Sdn Bhd
Level 41, Menara Maybank, 100, Jalan Tun Perak, 50050 Kuala Lumpur
Tel: 603 2032 2188
Preferred investment stage: Start-up, mezzanine and Pre-IPO

Mezzanine Capital (Malaysia) Sdn Bhd
2.01, Amcorp Tower, No. 18, Jalan Persiaran Barat, 46050 Petaling Jaya, Selangor
Tel: 603 7966 2300
Preferred investment stage: Mezzanine and Pre-IPO

MSC Venture One Sdn Bhd
MSC Headquarters, 2360 Persiaran APEC, 63000 Cyberjaya, Selangor
Tel: 603 8315 3000
Preferred investment stage: Seed, start-up and expansion

Musharaka Tech Venture Sdn Bhd
9-2, Platinum Walk, 2 Jalan Langkawi, Danau Kota, 53300 Setapak, Kuala Lumpur
Tel: 603 4142 7285
Preferred investment stage: Expansion and Pre-IPO

OSK Technology Ventures Sdn Bhd
15th Floor, Plaza OSK, Jalan Ampang, 50450 Kuala Lumpur
Tel: 603 2161 7233
Preferred investment stage: Expansion and Pre-IPO

Pembangunan Ekuiti Sdn Bhd
Level 3, Menara Bank Pembangunan, Bandar Wawasan 1016, Jalan Sultan Ismail, 50724 Kuala Lumpur
Tel: 603 2692 2962
Preferred investment stage: Expansion

Resilient One Sdn Bhd
34, Jalan SS 6/8, Kelana Jaya, 47301 Petaling Jaya
Tel: 603 7880 8092
Preferred investment stage: Start-up

Singularity Ventures Sdn Bhd
Unit No. 1-3A, The Loft, Bangsar, No.2, Jalan Penaga, Bukit Bandaraya, 59100 Kuala Lumpur
Tel: 603 2093 4044
Preferred investment stage: Early stage and start-ups

Springhill Bioventures Sdn Bhd
Level 4, No. 1, Jalan SS21/58 Damansara Uptown, 47400 Petaling Jaya, Selangor
Tel: 44 1483 890 574
Preferred investment stage: Seed, start-up and expansion capital

Teak Ventures Sdn Bhd
No. 22-01, Menara Dion, No. 27, Jalan Sultan Ismail, 50250 Kuala

Lumpur
Tel: 603 2031 2202
Preferred investment stage: Start-ups, expansion, Mezzanine and Pre-IPO

Trans Econ Ventures Sdn Bhd
18-2, Jalan 1/76 C, Desa Pandan, 55100 Kuala Lumpur
Tel: 603 9281 6588
Preferred investment stage: Seed, start-up, mezzanine and Pre-IPO

TruPartners Sdn Bhd
M-2-1, Plaza Damas, No. 60, Jalan Hartamas 1, 50480 Kuala Lumpur
Tel: 603 6203 3030
Preferred investment stage: Expansion, mezzanine and Pre-IPO

Zenith Capital Partners Sdn Bhd
34, Jalan SS6/8, Kelana Jaya, 47301 Petaling Jaya, Selangor
Tel: 603 7880 8092
Preferred investment stage: Start-up

Appendix 4

Government Organizations Providing "Grant Schemes"

Ministry of Science, Technology and Innovation
Aras 1-7, Blok C4 & C5, Komplek C, Pusat Pentadbiran Kerajaan Persekutuan, 62662, Putra Jaya
Tel: 603 8885 8000
Grant schemes offered:
- Science fund, TechnoFund, eContent Fund, InnoFund and DAGS

Malaysian Biotechnology Corporation
Level 23, Menara Atlan, 161, Jalan Ampang, 50450, Kuala Lumpur
Tel: 603 2116 8585
Grant schemes offered:
- Seed fund, R&D matching fund and international business development fund

Malaysian Technology Development Corporation Sdn Bhd
Level 8-9, Menara Yayasan Tun Razak, Jalan Bukit Bintang, 55100 Kuala Lumpur
Tel: 603 2172 6000
Grant schemes offered:
- Technology commercialization (CRDF) and technology acquisition (TAF)

Small and Medium Enterprise Corporation Malaysia
Aras 20, West Wing, Menara MATRADE, Jalan Khidmat Usaha, off Jalan Duta, 50480 Kuala Lumpur
Tel: 603 6207 6000
Grant schemes offered:
- Various types of grant schemes

Cradle Sdn Bhd
Suite 4.8.1, Level 4, PNB Darby Park, 10, Jalan Binjai, 50450 Kuala Lumpur
Tel: 603 2166 4730
Grant schemes offered:
- Seed fund to commercialize ideas

Malaysian External Trade Development Corporation (MATRADE)
Menara MATRADE, Jalan Khidmat Usaha, Off Jalan Duta, 50480 Kuala Lumpur
Tel: 603 6207 7077
Grant schemes offered:
- Market development grant and brand promotion grant

Government Development Finance Institutions

Bank Pembangunan Malaysia Berhad
Menara Bank Pembangunan, Bandar Wawasan, No. 1016, Jalan Sultan Ismail, 50250 Kuala Lumpur
Tel: 603 2611 3888
Services offered: Medium and long term loans

Malaysian Debt Ventures Berhad
Level 5, Menara Bank Pembangunan, Bandar Wawasan, No. 1016, Jalan Sultan Ismail, 50250 Kuala Lumpur
Tel: 603 2617 2888
Services offered: Medium and long term loans to ICT and Biotech sectors

Malaysian Industrial Development Finance Berhad
Level 21, Menara MIDF, 82, Jalan Raja Chulan, 50206 Kuala Lumpur
Tel: 603 2173 8888
Services offered: Medium and long term loans

THE LANGUAGE OF PRIVATE EQUITY

Advisory board A set of limited partners or outsiders who advise a private equity organization. The board may, for instance, provide guidance on overall fund strategy or ways to value privately-held firms at the end of each fiscal year of a private equity fund.

Add-on-service The services provided by a private equity that are not monetary in nature, such as helping to assemble a management team and helping to prepare the company for an Initial Public Offering (IPO).

Agreement of limited partnership See Partnership Agreement.

Angel investor A wealthy individual who invests in entrepreneurial firms. Although angel investors perform many of the same functions as private equity investors, they invest their own capital rather than that of institutional and individual investors.

Asset allocation The process through which institutional or individual investors sets targets for how their investment portfolios should be divided across the different asset classes.

Asset class One of a number of investment categories – such as bonds, real estate and private equity-that institutional and individual investors would take them into consideration when making asset allocation.

Associate A professional employee of a private equity firm who is not yet a partner.

Bogey See Hurdle rate.

Burn rate The rate at which a company expends net cash over a certain period, usually a month.

Business Plan A document that describes the entrepreneur's idea, the market problem, business and revenue models, marketing strategy, technology, company profile, competitive landscape, as well as financial data for coming years. The Business Plan begins with a brief executive summary, probably the most important element of the document due to time constraints of private equity managers.

Capital gain The difference between an asset's purchase price and selling price.

Capital structure The mixture of equity and debt that a firm has raised.

Capital under management See Committed capital.

Carried interest The substantial share, often around 20% of profits that are allocated to the general partners of a private equity partnership.

Closed-end fund A publicly traded mutual fund whose shares must be sold to other investors (rather than redeemed from the issuing firm, as is the case with open-end mutual funds). Many early private equity funds were structured in this manner.

Closing The signing of a contract by an investor or group of investors that bind them to supply a set amount of capital to a private equity fund. Often, a fraction of that capital is provided at the time of closing. A single fund may have multiple closings.

Co-investment Either (a) the syndication of a private equity financing round (see syndication), or (b) an investment by an individual general or limited partner alongside a private equity fund in a financing round.

Committed capital Pledges of capital to a private equity fund. This money is typically not received at once, but rather is taken down over three to five years starting in the year it formed.

Common stock The equity typically held by management and founders of companies. Typically, at the time of an initial public offering, all equity is converted into common stocks.

Convertible equity or debt A security that under certain conditions can be converted into another security (often into common stock). The convertible shares often have special rights that common stock does not have.

Corporate venturing Private equity capital provided by in-house investment funds of large corporations to further their own strategic interests.

Deal flow The measure of the number of potential investments that a fund reviews in any given period.

Deal structure An agreement made between the investor and the company defining the rights and obligations of the parties involved. The process by which one arrives at the final term and condition of the investment.

Dilution The reduction in the fraction of a firm's equity owned by founders and existing shareholders associated with a new financing round.

Disbursement An investment by a private equity fund in a company.

Distribution The transfer of shares in a portfolio firm or cash from a private equity fund to a limited partner and (frequently) each general partner.

Draw down See Take down.

Due diligence The review of a business plan and assessment of a management team prior to a private equity investment.

Early stage A state of a company that typically has completed its seed stage and has a founding or core senior management team, has proven its concept, has minimal revenues, and no positive earnings or cash flows.

Exit The means by which a private equity firm realizes a return on its investment. Private equity investors generally receive their principal returns via capital gain on the sale or flotation of investments. Exit methods include a trade sale (most common), flotation on a stock exchange (common), a share repurchase by the company or its management or a refinancing of the business (least common). A secondary purchase of the limited partnership (LP) by another private equity firm is becoming an increasingly common exit method for private equity firms.

Exit route The method by which an investor would realize an investment.

Financing round The provision of capital by a private equity manager to a firm. Since a private equity firm generally provides capital in stages, a typical private equity-backed firm will receive several financing rounds over a series of years.

First closing The initial closing of a private equity fund.

Funds of fund A fund that invests primarily in other private equity funds rather than operating firms, often organized by an investment adviser or investment bank.

General partner A partner in a limited partnership who is responsible for the day-to-day operation of the fund. In the case of a private equity fund, the private equity managers either are general partners or own the corporation that serves as the general partner. The general

partner assumes all liability for the fund's debt.

Greenfield venture A company which has no track record and is starting up from research.

Hurdle rate Either (i) the set rate of return that the limited partners must receive before the general partners can begin sharing any distributions, or (ii) the level that the fund's net asset value must reach before the general partners can begin sharing any distributions.

Independent private equity funds Private equity funds which are established by non financial institutions. They raise their money from institutional and other investors.

Investment committee A group typically consisting of general partners of a private equity fund, that reviews potential and or existing investments.

Later stage A fund investment strategy involving financing the expansion of a company that is producing, shipping and increasing its sales volume. Later stage private equity funds often provide the financing to help a company achieve critical mass in order to position its shareholders for an exit event.

Limited partner An investor in a limited partnership. Limited partners can monitor the partnership's progress but cannot become involved in its day-to-day management if they are to retain limited liability.

Limited partnership An organizational form that entails a finitely lived contractual arrangement between limited and general partners, governed by a partnership agreement.

Living dead A company that is making such insignificant profits and it is almost impossible to sell it, and even then would yield low returns.

Lock up A provision in the underwriting agreement between the investment bank and existing shareholders that prohibits corporate insiders and private equity investors from selling at the time of offering.

Management buy-in (MBI) A European term for leveraged buy out (LBO) initiated by a private equity group with no previous connection to the firm.

Management buy-out (MBO) A European term for an LBO initiated by an existing management team, which then solicits the involvement of a private equity group.

Management fee The fee, typically a percentage of committed capital or net asset value, that is paid by a private equity fund to the general partners to cover salaries and expenses.

Mezzanine Either (a) a private equity financing round shortly before an initial public offering, or (b) an investment that employs subordinated debt that has fewer privileges than bank debt but more than equity and often has attached warrants.

Net asset value (NAV) The value of a fund's holding, which may be calculated using a variety of valuation rules. The value does not include funds that were committed but not drawn down.

Net present value (NPV) A valuation method that computes the expected value of one or more cash flows and discount them at a rate that reflects the cost of capital (which will vary with the cash flow's level of risk).

Partnership agreement The contract that explicitly specifies the compensation and conditions that govern the relationship between investors (limited partners) and private equity managers (general partners) during a private equity fund's life.

Point One Percent of a private equity fund's profits. The general partners of a private equity fund are often allocated 20 points, 20 percent of the capital gain, which are divided among the individual partners.

Post-money valuation The product of the price paid per share in a financing round and the shares outstanding after the financing round.

Pre-money valuation The product of the price paid per share in a financing round and the shares outstanding before the financing round.

Private equity Organizations devoted to venture capital, leveraged buyouts, mezzanine, and distressed debt investments, as well as a variety of hybrids such as venture leasing and venture factoring.

Right of first refusal A contractual provision that gives a corporation or private equity fund the right to purchase, license, or invest in all opportunities associated with another organizations before other companies or funds can do so. A weaker form of this provision is termed the right of first look.

Secondary offering An offering of shares that are not being issued by the firm but rather are sold by existing shareholders. Consequently, the firm does not receive the proceeds from sales of these shares.

Seed stage financing An initial state of a company's growth characterized by a founding management team, business plan development, prototype development and beta testing.

Staging The provision of capital to entrepreneurs in multiple installments, with each financing conditional on meeting particular business targets. This provision helps ensure that the money is not squandered on unprofitable projects.

Sweat equity Ownership of shares in a company resulting from work

rather than investment of capital-usually founders receive “sweat equity”.

Syndication The joint purchase of shares by two or more private equity organizations or the joint underwriting of an offering by two or more investment banks.

Take down The transfer of some or all of the committed capital from the limited partners to a private equity fund.

Take down schedule The contractual language that describes how and when a private equity fund can receive the committed capital from its limited partners.

Term sheet A preliminary outline of the structure of a private equity partnership, frequently agreed to by the key parties before the formal contractual language is negotiated.

Trade sale The sale of the equity share of a portfolio company of a private equity fund to another company.

Valuation rule The algorithm by which a private equity funds assigns values to the public or private firms in its portfolio.

Venture capital Independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high-growth companies. Outside the United States, this phrase is often used as a synonym for private equity.

Venture capitalist A general partner or associate at a private equity organization.

Venture factoring A private equity investment strategy that involves purchasing the receivables of high-risk young firms. As part of the transaction, the venture factoring fund typically receives warrants in the young firm.

Venture leasing A private equity investment strategy that involves leasing of equipments or other assets to high-risk young firms. As part of the transaction, the venture leasing fund typically receives warrants in the young firm.

Warrants An option to buy shares issued directly by a company.

source: Bison Consulting and Malaysian Venture Capital and Private Equity Directory 2009.

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WHERE CAN ENTREPRENEURS FIND PRIVATE EQUITY AND GOVERNMENT GRANT SCHEMES?

The pool of private equity in Malaysia has grown significantly to over RM5.0 billion. There are also more than fifty firms providing private equity. Thus, there is more private equity capital chasing good private firms than ever before!

If you are an entrepreneur seeking private equity fund. this book is a required reading! It is written with the view of helping the entrepreneur to :

- Understand how a private equity manager makes an investment decision to invest in a particular company.
- Prepare and groom your company to be an attractive private equity investment.
- How to live with the private equity manager after an investment has been made.

About the Author

Dato' Anuar Md. Nor is a visiting lecturer at the International Business School, Universiti Teknologi Malaysia, teaching "Venture Management" class to MBA students. He is a leading expert in Malaysia on the private equity industry and has managed private equity funds in Malaysia and in Silicon Valley. He has an MSc. in Management of Technology from the Sloan School of Management, Massachusetts Institute of Technology, Boston, USA.